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ABSTRACT

Hearings concerning the activities of the Student Loan Marketing Association (Sallie Mae) are presented. Attention is focused on a request for an exemption under federal priority for recovering money owed the Association in the event that it files for liquidation or reorganization in the future under the Bankruptcy Act. It is noted that two goals of the Association are to provide a public service by assuring loan liquidity for student credit demands in the states, and to make a profit. Attention is directed to: the Association's organization, role, and activities; its performance as a quasi-government entity; new expanded authority of the Association to include virtually all functions of the Guaranteed Student Loan Programs, and the question of whether it has an unfair advantage in the marketplace over others that are involved in similar types of activities. Consideration is also given to the Association's direct or indirect responsibility to students and whether this responsibility conflicts with its obligations to its shareholders or bond holders. Publications and information are included on the legislative history of the Association and the probable consequences if the Association is unable to market its debt obligations in the public market. (SW)

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OVERSIGHT OF STUDENT LOAN MARKETING ASSOCIATION (SALLIE MAE)

ED235768

HEARING

BEFORE THE

SUBCOMMITTEE ON
EDUCATION, ARTS AND HUMANITIES

OF THE

COMMITTEE ON
LABOR AND HUMAN RESOURCES
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

TO INVESTIGATE THE ACTIVITIES OF THE STUDENT LOAN MARKETING ASSOCIATION (SALLIE MAE), FOCUSING ON A REQUEST FOR AN EXEMPTION UNDER FEDERAL PRIORITY FOR RECOVERING MONEY OWED THE ASSOCIATION

AUGUST 12, 1982

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OVERSIGHT OF STUDENT LOAN MARKETING ASSOCIATION (SALLIE MAE)

THURSDAY, AUGUST 12, 1982

U.S. SENATE,
SUBCOMMITTEE ON EDUCATION, ARTS AND HUMANITIES,
COMMITTEE ON LABOR AND HUMAN RESOURCES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:08 a.m., in room 4232, Dirksen Senate Office Building, Senator Robert T. Stafford (chairman of the subcommittee) presiding.

Present: Senators Stafford, Randolph, and Pell.

OPENING STATEMENT OF SENATOR STAFFORD

Senator STAFFORD. The Subcommittee on Education, Arts and Humanities will please come to order.

On behalf of the subcommittee, I will extend a welcome to our guests and our witnesses this morning. The Chair had been waiting for my dear colleague, the most able Senator from West Virginia, Senator Randolph, whom I know wishes to be here, but he, like Senator Pell, has conflicting commitments this morning and the Chair is going to go ahead and begin the meeting.

The Subcommittee on Education, Arts and Humanities is meeting today to conduct oversight of the activities of the Student Loan Marketing Association, commonly known as Sallie Mae.

Sallie Mae was established by the Education Amendments of 1972 to provide additional liquidity to lenders in the guaranteed student loan program. Through its major programs of loan purchase and warehouse advance, it has provided billions of dollars in student loan capital for direct guaranteed student loan lenders and loan guarantors. As of June 30 of this year, Sallie Mae had assets of more than $6 billion.

A program of this magnitude, even though it receives no directly appropriated Federal funds, deserves the close attention of this subcommittee. The purpose of the Federal student loan programs is to provide, on the most cost-effective basis possible, adequate capital to assist low- and middle-income families who choose to pursue higher education. Sallie Mae was established to conform with this purpose, and I hope that this hearing will illuminate us as to its activities in pursuit of this critically important goal.

The Chair is going to keep the record open at this point for any additional opening statements that other members of the subcommittee might wish to make.

Before we proceed further, the Chair is delighted to see that Senator Randolph is here. Senator Randolph, I have made a very brief opening statement and this would be an appropriate time for you to do the same if you wish.

Senator RANDOLPH. Thank you very much, Mr. Chairman.

More than a year after the fact, we are holding this hearing under your able chairmanship of our Subcommittee on Education to review the Student Loan Marketing Association's new authorities granted last year in the Omnibus Budget Reconciliation Act—for the record, Public Law 97-35—and particularly its request for an exemption under Federal priority for recovering moneys owed to it in the event that Sallie Mae files for liquidation or reorganization in the future under the Bankruptcy Act.

Since its inception in 1972, there have been few efforts to conduct oversight hearings on the Student Loan Marketing Association, and that is the reason we are here this morning. We will address, Mr. Chairman, not just the new authorities that have recently been granted to the Association, but all of its authorized activities that have taken place over the past 10 years.

On July 16, 1981, I received a telegram signed by eight State guarantee or lending agency officials expressing their collective concern over the new authorities for Sallie Mae in the reconciliation bill, and requesting that those provisions be removed until such time as public hearings could be held.

Now, regrettably, July 16 was too late for me to intervene in any meaningful way, since the budget bill was, by that time, in the Senate-House conference. I was not a conferee. I was, however, able to have language inserted in the conference report to the effect that the new authorities were not intended and could not be used to undermine or unfairly compete with existing State agency activities as participants in the guaranteed student loan program.

After the reconciliation of the budget was agreed to and signed into law, I asked our able chairman—and I refer to him always as our able chairman—Senator Stafford to schedule a hearing on those new loan authorities, and he very readily agreed.

Now, we have found that it is one thing to call for a hearing on Sallie Mae, and quite another to prepare for it. I will not try to detail for you the complexities involved in understanding Sallie Mae. I think it is sufficient to say that if most Members of Congress were asked what they thought of Sallie Mae, they would respond with a question, "Who is she?" That may be overdrawing it just a little.

Our staff—Mrs. Birdie Kyle and others—have worked and studied very diligently over the past year so that they and members of the subcommittee and committee as well would have a clear grasp of the issues at hand and would be able to assure, to the extent possible, that this hearing record would be meaningful.

Their work and the subcommittee's work has prepared us for appropriate questions so as to receive, hopefully, helpful, complete answers sufficient to alleviate the concerns expressed by the various State entities in relation to the authority of Sallie Mae.

I express my genuine thanks to the staff for the work that has gone into this hearing and preparation for it, and my gratitude to the many persons and groups who have met with our staff to give

us the benefit of knowledge and expertise. And last but certainly not least, my thanks to the Congressional Research Service—we do not mention them publicly too often—and its American Law Division for providing research and analyses of the authorities in question at my request over the past year.

I know that our subcommittee has been perhaps slow in responding to the need for oversight on the Student Loan Marketing Association. There may be many who wonder why we are locking the barn door—an old expression—after the horses have been stolen. But I believe that this hearing can be productive, and will be beneficial to all who are interested and concerned.

The telegram that I received on July 16, 1981, to which I have made reference from officials from the States of Minnesota, Colorado, Massachusetts, Wisconsin, Washington, Nebraska, and West Virginia stated—and I quote the telegram:

> We share great misgivings about provisions in both bills which will greatly expand the authority and areas of activities for the Student Loan Marketing Association, and view them as an encroachment of Sallie Mae on state initiatives and responsibilities. We urge you and your colleagues to give this matter the study and hearings which it deserves.

That was an excerpt from the telegram.

State officials have indicated to the subcommittee in very certain terms that we have been rather cavalier about enacting into law amendments that benefit Sallie Mae over the past 10 years and that we have done so more and more without the benefit of public debate.

I regret that that allegation is true. However, we have probably been reluctant to hold hearings because of Sallie Mae being, in a sense, a very complex financial operation, I will pause at that point to say that sufficient time to thoroughly study this issue has always been a problem for me and for members of our staff.

We have trusted Sallie Mae to fairly represent its real needs, and have proceeded to adopt new amendments because we did not done delay action that could result in preventing students, desiring to obtain a guaranteed loan or loans for college tuition, from being able to do so.

Sallie Mae, on the other hand, probably has also reached a point where they described their rather substantive amendments as technical in nature because they were discouraged from explaining their operations and questioned whether anyone would listen if they had explained them. The blame, if any, for a lack of proper oversight rests with both sides.

Now, I wish to reiterate that despite popular belief, this hearing is not intended in any nature to be punitive. There is no doubt in our minds that Sallie Mae has provided a vital service in assuring student access to guaranteed student loans, and that has been nationwide.

However, there is no doubt in our minds, many of us, that State agencies and other lending institutions have, over a period of years, expressed a growing anxiety over the sudden appearance of new Sallie Mae authorities that have not been publicly discussed. The fact if that when State officials ask our staff for details as to the intent of the new initiative, our staff, Senator Stafford, has ad-

mittedly been unable to respond with any depth and degree of knowledge.

In other words, the concern is present and we want to have it alleviated, and I believe that this hearing can help toward that end.

The Congress created Sallie Mae in 1972, with two distinct goals: One, to provide a public service by assuring liquidity, or cash flow, to lenders willing to participate in the guaranteed student loan program; and, two, for making a profit.

For years, that organization has gone about its task; they have done the task well. As a matter of fact, they were and still are especially good at making a profit. They are very successful. Some say they are too successful. Some say that in order to assure a wide profit margin, Sallie Mae has forgotten its first goal—to provide the public service of loan liquidity for student credit demands in the States, and I have mentioned States that have directly contacted me.

Others say that Sallie Mae has suddenly become very, very conservative in agreeing to provide loan liquidity, to the detriment of State lending agencies or guarantors who require advance cash commitments to meet the credit demand of students.

I believe that members of our subcommittee, State agencies, the general public and Sallie Mae officials will hopefully, at the conclusion of this hearing or hearings, have a better communications operation established among them. We have need for more than a glimmering of understanding of Sallie Mae. We do not want the mystery to continue, and the inner workings of student loan marketing activities shall be clarified for all concerned.

Mr. Chairman, I believe it would be wise for us to ask the General Accounting Office to conduct an indepth study, audit and report for this subcommittee on Sallie Mae's activities over the past 10 years, and an evaluation, if possible, of the intended future use of recently granted new loan authorities contained in Public Law 97-35.

That GAO report, combined with the hearing record that we will compile today should serve to relieve most of the fears and anxieties that are shared by many of the participants in the student loan marketing field.

I must remind you that the States contacted us, so there must be some reason why they feel the necessity for this hearing. If this hearing does nothing else, I would hope it will answer questions about whether Sallie Mae has been doing a good job as a quasi-Government entity, and whether it has in fact had an unfair advantage in the marketplace over others that are involved in similar types of activities.

I will have questions that I will ask for the record, and other questions I request permission of our chairman to submit for written responses so that we will be able to save time.

Senator STAFFORD. Without objection, that right will be reserved to all members of the subcommittee.

Senator RANDOLPH. Thank you, Mr. Chairman. I also request permission of the chairman to include certain documents, including research papers that have been prepared by the Congressional Research Service at my request, and copies of correspondence be-

tween the president of Sallie Mae and myself, dating from August 7 through October 5, 1981, in which I asked questions related to last year's new authorities and to which Mr. Fox responded.

I thank you.

Senator STAFFORD. Without objection, those documents will be made part of the hearing record.

[The documents referred to follow:]

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OC ST. PAUL , MINNESOTA JULY 16, 1981
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western union **Telegram**

THE HONORABLE JENNINGS RANDOLPH
U.S. SENATE
3203 DIRKSEN SENATE OFFICE BLDG.
WASHINGTON, D.C. 20510

EACH OF US HAS EXPRESSED OUR RESPECTIVE STATE POSITIONS AND CONCERNS ABOUT THE EFFECTS OF CHANGES IN FEDERAL POST-SECONDARY POLICY INCORPORATED IN THE BUDGET RECONCILIATION BILLS CURRENTLY UNDER CONFERENCE. HOWEVER, WE ALSO SHARE GREAT MISGIVINGS ABOUT PROVISIONS IN BOTH BILLS WHICH WILL GREATLY EXPAND THE AUTHORITY AND AREAS OF ACTIVITY FOR THE STUDENT LOAN MARKETING ASSOCIATION (SALLIE MAE). WHILE THESE PROVISIONS HAVE BEEN OFFERED AS TECHNICAL AMENDMENTS TO SECTION 439 OF THE HIGHER EDUCATION ACT, THEY CONSTITUTE MAJOR CHANGES IN POLICY AND SUBSTANCE WHICH HAVE NOT RECEIVED ANY HEARINGS IN EITHER HOUSE OF CONGRESS. WE OBJECT TO BOTH THE PROCEDURES AND SUBSTANCE RELATING TO THESE SECTIONS AND VIEW THEM AS AN UNWARRANTED ENCROACHMENT OF SALLIE MAE ON STATE INITIATIVE AND RESPONSIBILITIES. IN OUR JUDGMENT, THESE PROVISIONS ARE NOT GERMANE TO THE BUDGET RECONCILIATION PROCESS AND SHOULD EITHER BE REMOVED OR DELAYED FOR FURTHER STUDY. WE URGE YOU AND YOUR COLLEAGUES SERVING AS CONFEREES TO SOLICIT SUPPORT FOR FINDING A CONSTRUCTIVE WAY TO GIVE THIS MATTER THE STUDY AND HEARINGS WHICH IT DESERVES.

SIGNED:

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western union **Telegram**

▶ SENATOR JENNINGS RANDOLPH RPT DLY MGM

ROOM 3203 DIRKSEN
CAPITOL ONE DC 20510

SENATOR RANDOLPH,
WE BELIEVE THE PROPOSED STUDENT LOAN MARKETING ASSOCIATION MODIFICATIONS IN THE PROPOSED BUDGET RECONCILIATION LEGISLATION IS INAPPROPRIATE SINCE SUCH CONSIDERATION SHOULD COME VIA REGULAR REAUTHORIZATION AND SINCE SUCH CHANGES COULD ENDANGER THE IMPORTANT STUDENT LOAN SECONDARY MARKET MISSION. WE URGE THE MODIFICATION LANGUAGE BE DELETED

BEN MORTON
PO BOX 591
CHARLESTON WV 25322

13102 EST

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JENNINGS RANDOLPH
WEST VIRGINIA

United States Senate

WASHINGTON D.C. 20510

COMMITTEES
ENVIRONMENT AND PUBLIC WORKS
LABOR AND HUMAN RESOURCES
VETERANS AFFAIRS

August 7, 1981

Mr. Edward A. Fox
President
Student Loan Marketing Association
1050 Thomas Jefferson Street, N.W.
Washington, D. C. 20007

Dear Mr. Fox:

Recently the Association sought, and was given, Congressional authority to expand its role to include virtually all functions of the Guaranteed Student Loan Program. This new expansion authority was partially authorized in the Education Amendments of 1980, and more fully authorized in the Postsecondary Education Student Assistance Amendments of 1981, contained in the Omnibus Budget Reconciliation Act.

As originally conceived, the efforts and resources of the Association were to be dedicated exclusively to increasing liquidity of lenders originating guaranteed student loans through such activities as purchasing loans from lenders and making warehousing advances to lenders, with student loan notes of the lender as collateral. The increased authority expands the Association's role to include the functions of originating loans, insuring loans, and underwriting revenue bonds issued by States and non-profit organizations to obtain funds for student loans. In addition, the authority to undertake any activity with respect to uninsured loans as the Association may undertake with regard to insured loans gives the Association rather broad authority to establish and participate in student loan programs which, presumably are neither sponsored nor controlled in any manner by Federal statute, the Congress or any Federal agency.

This substantial expansion in the role and authority of the Association stimulates many questions in the minds of lenders, particularly State Lending or Guaranty Agencies. It will be appreciated if you will furnish me with a detailed response to the following question:

> In view of the anticipated entry of the Association into ventures which include virtually all Guaranteed Student Loan Program functions and non-Federal programs as well, how does the Association see its emerging role, and what priority will the Association establish in allocating its efforts and resources among the variety of functions for which it has sought authority?

Looking forward to a response at the earliest practicable date, I am

Truly,

COPY

Jennings Randolph

[redacted]

United States Senate

COMMITTEE ON LABOR AND
HUMAN RESOURCES
WASHINGTON, D.C. 20510

August 21, 1981

Honorable Edward A. Fox
President
Student Loan Marketing Association
1050 Thomas Jefferson Street, N.W.
Washington, D.C. 20007

Dear Mr. Fox:

In view of the fact that Congressional action to expand the Association's role during the Reconciliation process was done with little or no public input or notification, questions continue to be raised by concerned organizations and individuals. It will be appreciated if you will furnish me with a detailed response to the following:

(1) Does the express desire of the Association to engage in essentially all functions related to the Guaranteed Student Loan Program and to conduct activities with respect to non-Federal programs reflect an assessment of the Association that future volume and profitability of the Association's secondary market program will not be adequate to assure success of the Association without new ventures?

(2) Is the availability of loans for purchase by the Association at a price which is profitable to the Association becoming more limited? In what way?

(3) Will the funds borrowed from the Federal Financing Bank be used by the Association for its activities with respect to loans which are not originated under any Federal program?

(4) In view of the likelihood that funds can be borrowed at a lower rate of interest for insured loans than for uninsured loans, will the Association borrow separately for uninsured loans, or will combined borrowing for both insured and uninsured loans result in a higher cost of money for the Association and a corresponding reduction in price which the Association will be willing and able to pay in purchasing guaranteed student loans?

(5) In view of the fact that the 1980 Amendments gave the Association an exclusive franchise with respect to the origination of consolidation loans, even though a number of State agencies sought but were not granted similar loan consolidation authority, what evidence from loan consolidation experience of the Association indicates that the needs of students are being met most effectively by having loan consolidation authority vested only in the Association?

(6) What volume of consolidation loans has been originated by the Association since authority for origination of these loans was granted to the Association in the Fall of 1980?

(7) How fully has the need of students for consolidation loans been met by the Association?

Looking forward to a response to these questions at the earliest practicable date, I am

Truly,

Jennings Randolph

[boilerplate committee roster]

United States Senate

COMMITTEE ON LABOR AND HUMAN RESOURCES
WASHINGTON, D.C. 20510

August 24, 1981

Mr. Edward A. Fox
President
Student Loan Marketing Association
1050 Thomas Jefferson Street, N. W.
Washington, D. C. 20007

Dear Mr. Fox:

With reference to previous letters to you of a similar nature, additional questions have been submitted to me by concerned individuals and organizations with regard to the expanded role granted to the Association during the Reconciliation process. Again, it will be appreciated if you will furnish me with a detailed response to the following:

(1) How will the Association assure that the long-range financial viability of the organization is not impaired by holding loans which are not insured?

(2) In becoming an originator of guaranteed loans has the Association experienced any unforeseen difficulties, or has the secondary market program suffered in any way as the Association directed its attention to origination of loans?

(3) In view of the fact that the Association, which is a profit-making organization, has been granted authority to insure or guarantee loans under the Guaranteed Student Loan Program, would the Association favor an amendment which would permit other guarantors of student loans to operate as profit-making organizations?

(4) In view of the fact that the Association is being granted authority to guarantee its own loans, and because this authority eliminates some of the safeguards and checks and balances which prevail when a holder of a loan must be accountable to an independent guarantor or insurer of the loans, does the Association see the need for special monitoring by the Department of Education or other federal agency to protect against emergence of problems associated with the fact that the Association will be accountable only to itself as both the holder and insurer of some loans?

(5) How will the Association pay default claims to itself, and what is the likelihood that losses not reimbursed by the federal government will have a negative impact on the Association's financial capability to provide an effective secondary market?

Looking forward to a response at the earliest practicable date, I am

Truly,

Jennings Randolph

Jennings Randolph

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SEP 17

Chairman of the Board
STUDENT LOAN MARKETING ASSOCIATION
1050 Thomas Jefferson Street, N.W.
Washington, D.C. 20007
202 333-8000

EDWARD A. FOX
President

September 16, 1981

The Honorable Jennings Randolph
United States Senate
Washington, D.C. 20510

Dear Senator Randolph:

Thank you for your letters of August 7, August 21 and August 24 concerning questions raised by certain organizations and individuals relating to the new authorities granted to the Student Loan Marketing Association (Sallie Mae) under the Education Amendments of 1980 and the Postsecondary Student Assistance Amendments of 1981.

As you are aware, Sallie Mae was created by the 1972 amendments to the Higher Education Act of 1965 as a privately owned, for-profit corporation to be a secondary market for the Guaranteed Student Loan Program (GSLP). Subsequent legislation, including the two acts cited above, have broadened Sallie Mae's role to include, among other things, acting as a secondary market for Health Education Assistance Loans (HEAL), acting as a direct originator of GSLP loans under certain emergency situations, and providing loan consolidation for GSLP, HEAL, and NDSL loans for qualifying students.

Before responding to the individual questions raised in your letters, I should like to note that Sallie Mae is governed by a twenty-one member Board of Directors. Seven of these directors are elected as a class by shareholders which are educational institutions, seven are elected as a class by shareholders which are financial institutions, and seven are appointed by the President of the United States to represent the public interest. The President also chooses the Chairman of the corporation from among the twenty-one members. Sallie Mae's current Board has four members who represent states that have a student loan guarantee agency and a lending authority. The four are: E. T. Dunlap, Chancellor of the Oklahoma State Regents for Higher Education and also Chairman of Sallie Mae's Board; Teresa P. Hughes, Assemblywoman, California State Legislature; William Arceneaux, Commissioner of Higher Education for the State of Louisiana; and Ronald J. Jursa, Interim Associate, Superintendent for Postsecondary Education, Michigan Department of Education. The continuing advice and counsel furnished to the corporation by these members concerning the special

needs and interests of state lending and guarantee agencies have been extremely helpful to the corporation in planning and implementing its ongoing activities. The valuable input provided by these members, along with the recognition by the corporation that the role intended for state agencies is primary and integral to the continued success of the GSLP, have and will continue to assure that Sallie Mae's policies are designed to support and enlarge, rather than diminish, the activities of such agencies. It has been and will continue to be Sallie Mae's desire to limit its activities to a supporting and supplementary role in those areas where it shares overlapping authorities with state agencies. Accordingly, we would expect to utilize these dually shared authorities only in situations where an agency is unable to meet the needs of student borrowers.

With respect to the general question raised in your letter of August 7 concerning Sallie Mae's emerging role in the GSLP as a result of the recent legislative authorities relative to GSLP origination, guaranteeing, and insuring, I should note that in keeping with the above desire, these authorities are viewed as primarily contingent and supplementary in nature, to be implemented only as required by the changing needs of the GSLP and student borrowers. The corporation expects its primary role to continue to be that of a secondary market maker and consolidator of guaranteed student loans. One area of the recent legislation which Sallie Mae does view as vitally important is the provision clarifying Sallie Mae's ability to invest in student loan revenue bonds. Sallie Mae's ability to purchase these bonds would benefit more than twenty states who are currently dependent on this form of financing. Accordingly, the corporation expects to pursue such investments actively as soon as certain tax-related issues can be settled.

There are currently no plans to invest in non-insured student loans. It is our assumption that these loans would only be originated by financial or educational institutions at such time as there are insufficient funds or legislative authority to provide adequate credit to students under existing federal or state programs. If non-insured programs are essential to provide access to higher education to qualified students, Sallie Mae will assess the role it should play in providing a secondary market for such loans at that time.

The following questions were raised in your letter of August 21, 1981.

"(1) Does the express desire of the Association to engage in essentially all functions related to the Guaranteed Student

Loan Program and to conduct activities with respect to non-Federal programs reflect an assessment of the Association that future volume and profitability of the Association's secondary market program will not be adequate to assure success of the Association without new ventures?"

No. As noted above, Sallie Mae supported the recent expansion of its permitted activities based upon its recognition of a need to be responsive to lender and student borrower needs in a changing GSLP and financial environment. Although future amendments to the GSLP could undoubtedly reduce Sallie Mae's current levels of loan purchase, warehousing advance and commitment activity, we believe our primary role will continue to be that of a secondary market. The additional authorities granted by the recent amendments are viewed by the corporation as additional tools which will be available if necessary to fill urgent student credit needs and to provide timely support for the various delivery methods supporting student credit.

"(2) Is the availability of loans for purchase by the Association at a price which is profitable to the Association becoming more limited? In what way?"

We do not believe so. It is estimated that a total of $18 billion in GSLP loans will be outstanding at the fiscal year ending September 30, 1981. A total of $11 billion of such loans were outstanding at the end of the previous fiscal year. As a consequence of this program growth, Sallie Mae's purchases of loans during 1981 have been at record levels. Although this level of activity has at times put some strain on our resources, particularly our servicing capacity, we have been able to meet lenders' needs in a timely way and at prices we believe to be profitable to both Sallie Mae and lenders.

"(3) Will the funds borrowed from the Federal Financing Bank be used by the Association for its activities with respect to loans which are not originated under any Federal program?"

It is not our current plan to do so, with the possible exception of student loans which are guaranteed by some states and private non-profit agencies but which are not covered under the GSLP. An example of this type of loan are those guaranteed by the state of New York and made available to students who are not otherwise qualified for GSLP loans.

"(4) In view of the likelihood that funds can be borrowed at a lower rate of interest for insured loans than for uninsured loans, will the Association borrow separately for uninsured loans, or will combined borrowing for both insured and uninsured loans result in a higher cost of money for the Association and a corresponding reduction in price which the Association will be willing and able to pay in purchasing guaranteed student loans?"

As noted above, Sallie Mae has no expectation of owning uninsured loans at this time. Should Sallie Mae at some point in the future undertake such purchases, it is unclear what impact such activities will have on its financing costs since these costs are primarily a function of current market perceptions of the corporation's earning power, management and creditworthiness. With respect to the effect such purchases might have on the price paid for insured loans, we would in general expect to pay more for guaranteed student loans than for loans which are not guaranteed. As a result, we do not believe that lenders making insured loans will, in effect, be required to subsidize lenders making uninsured loans should Sallie Mae begin purchasing uninsured loans.

With respect to questions (5), (6) and (7) of your August 7 letter, a loan consolidation pilot program designed to test the delivery mechanism and controls for this activity will commence this month. Although development of this program was essentially completed earlier this year, implementation had been held up awaiting final review and approval by the Department of Education, which was received last week. Since the response by the initial test group of 5,000 borrowers has not yet been received, it is too early to comment on the effectiveness of this program.

The following questions were contained in your letter of August 24, 1981.

"(1) How will the Association assure that the long-range financial viability of the organization is not impaired by holding loans which are not insured?"

At such time as the corporation considers owning such loans, appropriate credit and pricing standards and controls will be developed to protect the corporation. While such standards and controls cannot, of course, provide the financial safety of a guarantee, we believe that their use, along with other prudent business practices which might be applied, will help to assure

Sallie Mae's continued viability. In this general regard, Sallie Mae has always strived to conduct its activities on a sound business basis. Any activity involving non-insured loans would be structured on similar principles designed to limit Sallie Mae's potential financial exposure.

"(2) In becoming an originator of guaranteed loans has the Association experienced any unforseen difficulties, or has the secondary market program suffered in any way as the Association directed its attention to origination of loans?"

The corporation has not yet been called upon by the Secretary of Education or a state agency to originate student loans under the emergency provisions of Section 439(q). As indicated above, we have just now begun the process of originating loans under the loan consolidation program. To date, this latter activity has not adversely impacted Sallie Mae's existing secondary market activities as we have been able to hire additional qualified staff needed to perform this function. It is expected that additional staff would also be available if Sallie Mae were called upon to implement an emergency loan program under Section 439(q).

"(3) In view of the fact that the Association, which is a profit-making organization, has been granted authority to insure or guarantee loans under the Guaranteed Student Loan Program, would the Association favor an amendment which would permit other guarantors of student loans to operate as profit making organizations?"

It should be noted that the authority granted to Sallie Mae is limited, except with respect to consolidation loans, to responding to a request of the Secretary of Education in situations where no other guarantor can or will provide needed insurance. To date, the Secretary has not called upon Sallie Mae to perform this function nor is there any expectation that any such request will be made in the near future. In addition, there are no current plans or intentions on the part of Sallie Mae to request authorization from the Secretary to guarantee consolidation loans. We have no view at this time as to the propriety or utility of authorizing other entities to provide guarantees under similar circumstances, whether or not the entity is a profit-making organization. However, I have no reason to believe at this time that Sallie Mae would oppose the granting of a similar authority to such organizations.

"(4) In view of the fact that the Association is being granted authority to guarantee its own loans, and because this authority eliminates some of the safeguards and checks and balances which prevail when a holder of a loan must be accountable to an independent guarantor or insurer of the loans, does the Association see the need for special monitoring by the Department of Education or other federal agency to protect against emergence of problems associated with the fact that the Association will be accountable only to itself as both the holder and insurer of some loans?"

Based upon our understanding of the recent legislation, loans which might be made by Sallie Mae under the emergency provisions of Section 439(q) would be insured either by the federal government (if the state is not served by a state agency or non-profit insurer) or by a state agency or private non-profit insurer operating in the state. Consolidation loans authorized under Section 439(o) of the Act may be insured either by the federal government, a state agency or private non-profit insurer or, as you have noted, by Sallie Mae itself under agreements with the Secretary. In this latter case, the situation would be no different than in cases where currently a state agency or private non-profit agency may provide for both a direct lender and a guarantee authority. In these cases, so far as we know, appropriate and adequate steps have been taken to assure the integrity of the separate lending and guarantee functions without the need for extraordinary monitoring by either the Department of Education or any other federal agency.

"(5) How will the Association pay default claims to itself, and what is the likelihood that losses not reimbursed by the federal government will have a negative impact on the Association's financial capability to provide an effective secondary market?"

As is suggested by the answer to the previous question, claims will be paid on the basis of an independent determination of insurance liability. While we would, of course, expect that such claims would qualify for federal reinsurance under agreements with the Secretary, our corporation would not undertake any program of loan insurance unless we were first satisfied that such a program could be structured and conducted on a sound financial basis consistent with both the promotion of the Consolidation Loan Program and our general secondary market activities.

I trust that the above information has been responsive to your inquiries. Please do not hesitate to contact me if I can be of any further assistance.

Very truly yours,

Edward A. Fox

Edward A. Fox
President

cc: Mrs. Birdie Kyle

[boilerplate committee roster]

United States Senate

COMMITTEE ON LABOR AND
HUMAN RESOURCES
WASHINGTON, D.C. 20510

September 15, 1981

Mr. Edward A. Fox
President
Student Loan Marketing Association
1050 Thomas Jefferson Street, N. W.
Washington, D. C. 20007

Dear Mr. Fox:

This letter is in furtherance of my previous correspondence with you concerning questions that have been raised in regard to the expanded role granted to the Association during the Reconciliation process. It will be most appreciated if you will furnish me with a detailed response to the following:

(1) What volume of loans does the Association expect to originate during the next 12 months? The next 5 years?

(2) What volume of loans does the Association expect to guarantee during the next 12 months? The next 5 years?

(3) What volume of revenue bonds does the Association expect to underwrite during the next 12 months? The next five years?

(4) What are the terms, including price, according to which the Association currently is offering to purchase guaranteed student loans, and according to what terms, including price, does the Association expect to purchase non-insured loans?

(5) In what ways, if any, will lenders experience an improved secondary market as a result of any of the new authority for the Association?

(6) In view of the increasingly broad authority for the Association to engage in virtually all functions with respect to the Guaranteed Student Loan Program, to develop and participate in programs not authorized by the Congress or sponsored by the Federal government, to underwrite revenue bonds, to originate loans, and to engage in virtually any activities which the Association's Board determines to be supportive of the credit needs of students, how can the Congress be assured that activities of the Association will be consistent with sound public policies and goals acceptable to the Congress?

Looking forward to a response at the earliest practicable date, I am

Truly,

Jennings Randolph

RECD OCT 8 198

Chartered by Act of Congress
STUDENT LOAN MARKETING ASSOCIATION
1050 Thomas Jefferson Street N.W.
Washington, D.C. 20007
202-333-8000

EDWARD A. FOX
President

October 5, 1981

The Honorable Jennings Randolph
United States Senate
Washington, D.C. 20510

Dear Senator Randolph:

Thank you for the opportunity to respond to the additional questions raised in your letter of September 15, 1981.

1. Our current forecast estimates that approximately $300 million in loan consolidations will be undertaken by Sallie Mae in 1982. As was stated in response to one of your earlier questions, we are currently undertaking a pilot program and our experience under this program will give us a better means of estimating future volume. The difficulty in forecasting is increased because there is no existing data base which provides us with adequate information relative to total student indebtedness. We currently do not anticipate originating loans during the next twelve months under any other program. Because of potential changes to the underlying programs and the lack of meaningful data, we are unable to make any definitive forecast beyond 1982.

2. The corporation has no expectation of guaranteeing any loans during 1982. Because of the contingent nature of this authority, which would require an emergency situation for its use, we are unable to speculate as to future plans. As mentioned in our previous response, Sallie Mae at some point may request of the Secretary the right to guarantee loans originated by Sallie Mae in a consolidation process. There is no such request pending or contemplated at this time.

3. The corporation does not have any current plan to become a revenue bond underwriter in the foreseeable future. However, if future conditions indicate that Sallie Mae could provide an attractive service to states at a competitive cost, thereby reducing states' costs of operation, then Sallie Mae will consider establishment of such an operation. Recently, the Administration indicated that it will propose legislation that could limit or cancel the authority of states to issue

revenue bonds for housing, industrial development and student loans, among other things. Such action by the Congress would render this question relative to Sallie Mae's authorities to be moot.

4. Generally speaking, a portfolio in which the average student indebtedness is approximately $4200 qualifies for a par purchase by Sallie Mae. Because of the large number of variables that are built into the pricing model, no two portfolios offered for sale will price the same. During the past few years, nearly all of our portfolio purchases have been at par as users of our programs have accumulated portfolios, primarily of graduating seniors, that meet our requirements for a par purchase. Since the corporation has never purchased non-insured loans, has no intention to do so in the near future, and has no idea of what the characteristics of such loans might be, we cannot anticipate the value of those loans to Sallie Mae, and therefore the price, at this time.

5. As stated in our previous response, the major thrust of the legislation in the Omnibus Budget Reconciliation Act of 1981 was to provide Sallie Mae with contingent and supplementary authority to be implemented only in emergency situations and as required by the changing needs of the GSLP and student credit needs. However, we do believe that the authority to purchase revenue bonds from states could have a very positive benefit on the more than twenty states that finance lender-of-last-resort and secondary market programs through the sale of revenue bonds. Currently these markets are in disarray and many states are having difficulty in raising capital to support these worthwhile programs.

6. Sallie Mae was chartered by the 1972 amendments to the Higher Education Act of 1965, is subject to oversight by the Congress and, by law, is required to file an annual report of its activities to the Congress. Sallie Mae's enabling legislation also has given specific oversight and approval authorities relative to Sallie Mae to the Secretary of the Treasury and the Secretary of Education. Also, under statute, the President of the United States appoints seven members to the Board of Directors and designates the Chairman of the Board of Directors, which group has oversight of the policy of the corporation. Specific legislation relative to Sallie Mae during the past nine years, with supportive instruction and commentary in the accompanying reports, has created a clear mandate for the corporation in support of student financial aid in general, and the GSLP in particular. The Board of Directors and the management of the corporation, mindful of the legislative and executive branch oversight, are aware that the corporation is both responsible and accountable for its actions. We believe that Congress in its wisdom has put in place a series of responsibilities

and controls which assure that Sallie Mae, as a private, for-profit entity, will function as a financially sound credit intermediary which is cognizant of the needs of the student population it serves.

Please let me know if I can be of any further assistance.

Very truly yours,

Edward A. Fox

Edward A. Fox,
President

cc: Mrs. Birdie Kyle

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

December 9, 1981

TO : Honorable Jennings Randolph
Attention: B. Kyle

FROM : David Osman
Analyst in Education
Education and Public Welfare Division

SUBJECT : Probable Consequences If the Student Loan Marketing Association (Sallie Mae) is Unable to Market its Debt Obligations in the Public Market

The Student Loan Marketing Association (Sallie Mae) is a private corporation chartered by the Congress in 1972 to provide liquidity to financial institutions participating in the Guaranteed Student Loan (GSL) program. Sallie Mae currently provides liquidity to GSL lenders in two principal ways: (1) through purchases of GSLs from lenders' portfolios, and (2) through "warehousing advances" (loans) to lenders, using lender GSLs as collateral for funds to make additional student loans. Sallie Mae's function as a secondary market for the GSL program also assists States in the marketing of State bonds for student loans by providing the guarantee of a "takeout." 1/ This takeout guarantee is necessary in some States for the bond issue to get an investor grade rating.

As of September 30, 1981, Sallie Mae reported program assets of approximately $4.3 billion: $1.8 billion in GSLs purchased and $2.5 billion in warehousing advances. Since 1974, Sallie Mae has funded its operations primarily

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1/ Essentially, a "takeout" is the sale of a bond obligation of one party to a second party who agrees to assume the obligations of the bond contract, for a fee.

from the sale of debt obligations to the Federal Financing Bank (FFB). 2/ In March 1981, Sallie Mae entered into an agreement with the FFB, the Secretary of the Treasury, and the Secretary of Education to cease using FFB funds as of September 30, 1982, or when the aggregate total of such FFB borrowing reached $5 billion, whichever occured first. At this time, Sallie Mae also agreed to begin borrowing in the public market without benefit of Federal guarantees.

As of December 9, 1981, Sallie Mae had "drawn down" approximately $4.6 billion of its $5 billion FFB credit-line, with the remaining $400 million expected to be used by early 1982. Sallie Mae has also been selling short-term discount notes as a secondary source of working capital since May 1981. Since May, the dollar amounts of such notes outstanding generally has ranged from about $100 to $450 million.

Debt Obligations Problem

To replace borrowing from the FFB as its major source of working capital, Sallie Mae planned to sell intermediate term bonds (approximately 5 to 7 years to maturity) beginning the first week in December, 1981. As final preparations were underway for the intital bond offering, a question arose concerning the priority of Federal debt over debt owed to other creditors.

According to Sallie Mae, an amendment to its authorizing legislation made by the Omnibus Budget Reconciliation Act of 1981 (Public Law 97-35) waived the Federal priority if Sallie Mae were to seek a voluntary liquidation under the Federal bankruptcy statutes. However, this Reconcilation amendment failed,

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2/ Sallie Mae was initially funded in 1972 through commercial bank lines of credit, the sale of short-term debt obligations, and the proceeds from the sale of common stock to financial and educational institutions. At the present time, the majority of Sallie Mae's working capital is from its FFB borrowings, supplemented by the sale of short term (15-30 day) discount notes and the use of retained earnings.

apparently, to resolve the Federal priority problem if Sallie Mae, or its creditors, were to seek relief in case of financial distress by any other means than voluntary liquidation. Thus, if Sallie Mae ever were to be reorganized, or placed in receivership or assignment for the benefit of creditors, the United States might have an absolute priority for Sallie Mae's assets, with the claims of other creditors relegated to a secondary position.

Sallie Mae believes that its proposed intermediate bond offerings are unmarketable until this question of the priority of Federal debt is clearly resolved in a manner which places all Sallie Mae debt obligations on an equal footing under all possible bankruptcy arrangements. (In the time available for this response, we have been unable to objectively verify this claim.) In an effort to resolve this problem, an amendment was accepted on November 20, 1981 during House debate on the Older Americans Act Amendments of 1981 (H.R. 3046). A copy of this amendment and subsequent House floor debate is included as Attachment A.

Probable Consequences if Sallie Mae is Unable to Publicly Market Its Debt Obligations

The central concern of this memorandum is the question, "what would be the probable consequences if Sallie Mae were unable to market its debt obligations in the public market?" In order to address this question, the following assumptions are made:

> --Sallie Mae's presentation of the facts in this matter is essentially correct (i.e., there really is a serious problem that makes a potential bond offering impossible to sell in the public market), 3/ and

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3/ As noted earlier, we have been unable to verify the correctness of this claim. It must be emphasized that this is simply an assumption, upon which the remaining discussion depends.

—The Reagan Administration through the FFB will not rescue Sallie Mae through the extension of additional FFB credit above the $5 billion ceiling now in place.

The paragraphs which follow discuss such probable consequences for three categories of affected parties— Sallie Mae, student borrowers, lenders and State guarantors--ending with a short discussion of the overall meaning for the GSL program.

1. Probable Consequences for Sallie Mae

Sallie Mae contends that the inability to sell its intermediate bond offerings in the near term would lead to a depletion of its working capital early in calendar year 1982. Without working capital, Sallie Mae's purchasing and warehousing of GSL's would come to a halt, and it would no longer be able to provide a takeout guarantee to States for their bond issues. It is also likely that Sallie Mae would not be able to meet all takeout commitments already made if there were a heavy demand for Sallie Mae to honor these prior agreements.

The inability of Sallie Mae to raise working capital through the bond market could also have a "ripple" effect on its ability to raise extensive additional capital via discount notes. Sallie Mae would continue to receive a return on the assets it already holds, but the amount of this return would be insufficient for Sallie Mae to meet its obligations.

In short, the inability of Sallie Mae to raise working capital through the bond markets probably would result in a severe cash flow problem which would leave Sallie Mae unable to perform its function as the major secondary market for the GSL program.

2. Probable Consequences for GSL Student Borrowers

If Sallie Mae were unable to provide liquidity to GSL lenders, many students seeking to borrow GSL funds probably would find a "tightening" supply of GSL funds, possibly leading to the total unavailability of GSLs in some

States. As discussed further in the succeeding paragraphs, the inability of Sallie Mae to provide lenders a secondary market for GSLs probably would limit the supply of funds available to potential student borrowers in a number of States in at least two ways:

(1) As lenders committed that portion of their total loan portfolios allocated to GSLs, students arriving "late" could find no loan funds left for them.

(2) As lenders who use Sallie Mae to sell or warehouse student loans assess the prospect of having to hold GSL's for their entire term, some lenders seem likely to cut back on their commitment to the program while others may drop out of participation altogether.

Although students in some States would not be as severely affected as in others due to wide variations among the States in the relative use of Sallie Mae at the present time, there seems little doubt that over a longer period of time most students seeking GSL assistance could be negatively affected by a national "deterioration" in the GSL program.

3. Probable Consequences for GSL Lenders and State Guarantors

For financial insitutions who use Sallie Mae, the inability to either sell or warehouse their GSL's probably would result in a significant decrease in the volume and amounts of GSLs that such lenders would be willing or able to handle. Faced with the prospects of illiquidity in their GSL portfolios, a number of these lenders might well determine that making more long-term GSL's to hold to maturity is not profitable and, thus, cease new loan activity.

At the State level, a minority of State Guarantee Agencies which currently have relatively few dealings with Sallie Mae might not be immediately affected by Sallie Mae's inability to make or honor takeout commitments on State bond issues for student loans. In a number of States, however, such an inability to honor existing, or make new takeout commitments probably would mean that such State bond issues would lose (or not initially obtain) a bond rating high

enough to attract sufficient numbers of investors. In turn, such a failure to raise State bond revenue would impair the operations of affected State Guarantee Agencies.

4. Probable Consequences for the GSL Program

In discussing the prospect of Sallie Mae not being able to effectively function as a secondary market for the GSL program, one State head of a GSL program termed the prospect "catastrophic" while another indicated that the permanent shutdown of Sallie Mae would have "a very severe impact on the availability of GSL loans nationally."

In the short run, it seems probable that a minority of States in which Sallie Mae does not play a large role might be little affected by the absence of a functional Sallie Mae. Over the long term, however, it would appear unlikely that the GSL program could remain a major, national option for students looking for postsecondary student financial assistance if Sallie Mae did "collapse" and was not replaced by another agency to perform its functions.

ATTACHMENT A

ttee staff and the staff of the man Resources Subcommittee.

Mr. Chairman, my amendment ould strengthen the Older Americans ct and the ombudsman program, and urge its adoption.

Mr. DeNARDIS. Mr. Chairman, will he gentleman yield?

Mr. RINALDO. I would be pleased o yield.

(Mr. DeNARDIS asked and was given permission to revise and extend his remarks.)

(Mr. DeNARDIS addressed the Committee. His remarks will appear hereafter in the Extensions of Remarks.)

Mr. RINALDO. Mr. Chairman, I thank the gentleman for his support and note that I very much appreciate it.

The CHAIRMAN. The question is on the amendment offered by the gentleman from New Jersey (Mr. RINALDO).

The amendment was agreed to.

AMENDMENT OFFERED BY MR. ERLENBORN

Mr. ERLENBORN. Mr. Chairman, I offer an amendment.

The Clerk read as follows:

Amendment offered by Mr. ERLENBORN: Page 39, after line 23, insert the following new section:

RETROACTIVE TECHNICAL AMENDMENT

SEC. 21. Section 439(1) of the Higher Education Act of 1965 is amended by adding at the end thereof the following new sentence: "The priority established in favor of the United States by section 3466 of the Revised Statutes (31 U.S.C. 191) shall not apply to indebtedness of the Association.".

□ 1500

The CHAIRMAN. The gentleman from Illinois (Mr. ERLENBORN) is recognized for 5 minutes.

(Mr. ERLENBORN asked and was given permission to revise and extend his remarks.)

Mr. ERLENBORN. Mr. Chairman, this amendment is a minor technical amendment to the Higher Education Act relating to the Student Loan Market Association (Sallie Mae). This amendment clarifies the status of Sallie Mae debt in the event of liquidation or other reorganization under the Bankruptcy Code and corrects a technical error made during the Omnibus Reconciliation Act.

Sallie Mae is a federally chartered corporation in existence since 1972 charged with providing liquidity to financial institutions participating in the guaranteed student loan program.

During reconciliation, Congress sought to facilitate the transition of Sallie Mae from an entity totally financed through Federal Financing Bank (FFB) borrowing to one financed through the public market. Through September 30, 1982, Sallie Mae will borrow over $5,000,000,000 through the FFB. In March 1981, with the strong support of the administration, Sallie Mae agreed with the FFB, the Secretary of the Treasury and the Secretary of Education to begin borrowing in the public market. In May of this year, Sallie Mae began offering nonguaranteed discount notes directly through selected securities dealers.

As these notes were being introduced, Sallie Mae discovered a 1797 bankruptcy statute that gave the U.S. Government first priority for all debts owing it. The effect of this provision, found at 31 U.S.C. 191, is to subordinate all Sallie Mae's public borrowing to the debt owed the FFB. As a result of this provision, Sallie Mae feared there would be no market for their nonguaranteed notes.

To address this unfavorable situation, Congress amended the Higher Education Act during reconciliation, to provide that in the event of liquidation, Sallie Mae's property would be distributed according to the usual priorities established under the Bankruptcy Code. The amendment failed to address what priorities would be utilized in the event of a reorganization or other remedy for the benefit of creditors, whether under the Bankruptcy Code or otherwise.

My technical amendment would clarify the status of Sallie Mae debt and considerably ease its entry into the public marketplace.

Mr. FORD of Michigan. Mr. Chairman, I move to strike the requisite number of words.

(Mr. FORD of Michigan asked and was given permission to revise and extend his remarks.)

Mr. FORD of Michigan. Mr. Chairman, I rise in support of the gentleman's amendment.

I would simply like to indicate that the amendment corrects an error in something that we did virtually by unanimous consent earlier this year in the reconciliation process.

The gentleman's amendment insures that Sallie Mae may continue to function as a private sector entity and be able to finance its needs in the public markets.

The Reconciliation Act amendment, which was intended to correct the situation, failed to provide any certainty on the priorities in the case of reorganization or other such remedies for the benefit of creditors, whether under the bankruptcy code or other statutes. Because of this uncertainty, Sallie Mae effectively has been denied access to the public markets, which it was intended to use. This amendment merely clarifies the situation and the intent of the Higher Education Act.

● Mr. SIMON. Mr. Chairman, I rise in support of the amendment offered by my colleague, JOHN ERLENBORN of Illinois. The amendment is technical in nature and is designed to correct an error in the amendments affecting the Student Loan Market Association (Sallie Mae) which are included in the Omnibus Budget Reconciliation Act of 1981 (Public Law 97-35). The Sallie Mae amendments, which were supported by the administration and my colleagues on both sides of the aisle, were intended to assist Sallie Mae in fulfilling its original purpose—to enter the public borrowing market and cease borrowing from the Federal Financing Bank (FFB). The amendments were defective because they failed to take into account an obscure bankruptcy statute which gives the U.S. Government first priority for debts owed to it. The practical effect is to subordinate all of Sallie Mae's public borrowing to the debts owed the FFB. Unless the amendment offered by Mr. ERLENBORN is adopted, Sallie Mae will be denied access to public debt markets and will continue to be dependent upon FFB borrowing.

Sallie Mae is an integral and essential part of the federally insured student loan system. Without Sallie Mae's secondary market and warehousing capability, many small and medium size banks would not participate in the guaranteed student loan program. In small cities and rural areas like my district in southern Illinois, no Sallie Mae means no guaranteed student loans which means no college education for many young people.

Since Congress clearly intended for Sallie Mae to function as a private corporation and to finance its needs through the public debt market, adoption of this amendment is essential. I urge my colleagues to support the Erlenborn amendment.●

The CHAIRMAN. The question is on the amendment offered by the gentleman from Illinois (Mr. ERLENBORN).

The amendment was agreed to.

AMENDMENT OFFERED BY MS. OAKAR

Ms. OAKAR. Mr. Chairman, I offer an amendment.

The Clerk read as follows:

Amendment offered by Ms. OAKAR: Page 10, line 20, strike out "(17)" and insert in lieu thereof "(18)".

Page 10, line 22, strike out "paragraph" and insert in lieu thereof "paragraphs".

Page 11, line 2, strike out "and" and all that follows through the end of such line.

Page 11, after line 2, insert the following:

"(17) provide assurances that, if a substantial number of the older individuals residing in any planning and service area in the State are of limited English-speaking ability, then the State will require the area agency on aging for each such planning and service area—

"(A) to utilize, in the delivery of outreach services under section 306(a)(2)(A), the services of workers who are fluent in the language spoken by a predominant number of such older individuals who are of limited English-speaking ability; and

"(B) to designate an individual employed by the area agency on aging, or available to such area agency on aging on a full-time basis, whose responsibilities will include—

"(i) taking such action as may be appropriate to assure that counseling assistance is made available to such older individuals who are of limited English-speaking ability in order to assist such older individuals in participating in programs and receiving assistance under this Act; and

"(ii) providing guidance to individuals engaged in the delivery of social services under the area plan involved to enable such individuals to be aware of cultural sensitivities and to effectively take into account linguistic and cultural differences; and".

SallieMae

STUDENT LOAN MARKETING ASSOCIATION

DISCOUNT NOTES

Note: This Report contains financial information with respect to Sallie Mae for the fiscal year ended December 31, 1980 which should be read in conjunction with Sallie Mae's quarterly reports for fiscal quarters subsequent to December 31, 1980. Copies of such quarterly reports can be obtained, when available, by writing to the Corporate Finance Department of Sallie Mae at 1050 Thomas Jefferson Street, N.W., Washington, D.C. 20007. The Notes referred to herein are not required to be registered under the Securities Act of 1933. Accordingly, no registration statement has been filed with respect to the Notes with the Securities and Exchange Commission. Sallie Mae is not subject to the periodic reporting requirements of the Securities Exchange Act of 1934.

May 1, 1981

SUMMARY

The Student Loan Marketing Association ("Sallie Mae") is a private corporation established in 1972 by an Act of Congress to provide liquidity for financial and educational institutions and other lenders engaged in the Federal Guaranteed Student Loan Program ("GSLP"). Sallie Mae has broad statutory authority to provide liquidity for lenders engaged in the GSLP, primarily through providing a secondary market for insured student loans and engaging in warehousing activities relating to such loans. See "Business and Operations".

Loans originated under the GSLP are either insured by the United States or made pursuant to student loan guarantee programs of states or non-profit private agencies operating under agreements with the Secretary of Education which provide for reinsurance by the United States of up to 100%. Under the GSLP the United States pays the interest on student loans (generally 9% for loans made after January 1, 1981 and 7% for loans made prior to that date) while the student is in school and during a "grace period" following the termination of studies. The United States also pays quarterly to the loan holders a "special allowance" on such loans throughout their term. The special allowance, taken together with the stated interest rate on the student loans, provides an effective interest rate approximately equal to the average coupon equivalent yield of all 13-week Treasury bills auctioned during each quarter, plus 3.5%. See "The Guaranteed Student Loan Program".

Sallie Mae obtains funds for its operations primarily from the sale of its debt obligations. In recent years, Sallie Mae has financed its activities principally through the issuance to the Federal Financing Bank ("FFB") of debt obligations guaranteed by the Secretary of Education. The FFB has agreed to lend up to a total of $5 billion to Sallie Mae prior to September 30, 1982. As of the date of this Report, $3.445 billion of this amount was outstanding. See "Business and Operations—Financing".

Description of the Notes:

The Notes described herein are offered by Sallie Mae from time to time on a discounted basis in bearer form with maturities of one year or less (generally not less than 30 days) in denominations of $100,000, $150,000, $1,000,000 and $5,000,000. *The Notes are not obligations of and are not guaranteed by the United States.* See "Discount Notes".

Eligibility for Investment:

The Notes described herein:

- are acceptable as security for the deposit of public monies subject to the control of the United States or any of its officers;
- are among those which, under Federal law, national banks may deal in, underwrite and purchase for their own accounts without limitation;
- are eligible as security for advances by Federal Reserve Banks;
- are legal investments for any portion of the assets of Federal savings and loan associations;
- are eligible to be purchased by Federal Reserve Banks under the direction of the Open Market Committee in their day-to-day implementation of monetary policy;
- are legal investments for Federal credit unions.

For further information regarding the eligibility of the Notes for investment, see "Discount Notes—Eligibility for Investment".

Offering Procedure:

The Notes are offered for sale to investors through a group of dealers selected by Sallie Mae. The Federal Reserve Bank of New York, as Clearing Agent, issues and redeems the Notes on behalf of Sallie Mae. Dealers in the Selling Group are: The First Boston Corporation; Goldman, Sachs & Co.; and Salomon Brothers.

Selected Financial Data:

	As of and for the years ended December 31, (Dollars in thousands except per share amounts)				
	1980	1979	1978	1977	1976
Interest income	$ 283,295	$ 140,794	$ 64,676	$ 37,250	$ 30,035
Interest expense	256,277	123,453	49,636	26,420	23,060
Net income	9,440	6,347	5,905	4,348	2,237
Earning assets:					
Loans purchased	1,217,068	722,177	438,051	271,354	197,118
Advances	1,421,622	707,621	413,966	241,469	214,019
Notes payable	2,720,000	1,506,000	915,000	515,000	410,000
Stockholders' equity	51,198	43,092	37,745	32,465	28,367
Earnings per share	9.44	6.35	5.90	4.35	2.24

STUDENT LOAN MARKETING ASSOCIATION

The Student Loan Marketing Association ("Sallie Mae") is a private corporation established by the 1972 amendments to the Higher Education Act of 1965, as amended (the "Act"), to provide liquidity, primarily through secondary market and warehousing activities, for student loans made by eligible lenders under the Federal Guaranteed Student Loan Program ("GSLP"). The GSLP is a program provided for by the Act and related legislation pursuant to which the United States insures, and various states and a limited number of non-profit private agencies guarantee, loans made to students by eligible lenders. The United States reinsures certain loans guaranteed by states and private agencies. See "The Guaranteed Student Loan Program". Under the Act, Sallie Mae is authorized to purchase, warehouse, service, sell, offer participations or pooled interests or otherwise deal in student loans insured under the GSLP and to make commitments for any of the foregoing. See "Business and Operations" for information as to the scope of the business activities in which Sallie Mae is authorized to engage and for information as to Sallie Mae's current and proposed operations.

Sallie Mae obtains operating funds primarily from the sale of its debt obligations. Funds can also be obtained from the sale of common and preferred stock. Sallie Mae receives no direct Federal funding for its operations. See "Business and Operations—Financing".

The principal office of Sallie Mae is at 1050 Thomas Jefferson Street, N.W., Washington, D.C. 20007, and its telephone number is (202) 333-8000.

CAPITALIZATION

The following table sets forth the capitalization of Sallie Mae:

	At December 31, 1980 (Dollars in thousands)
Debt:	
Notes payable(1)	$2,720,000
Stockholders' equity:	
Common stock, par value $16.67 per share; 1,000,002 issued(2)(3)	16,670
Additional paid-in capital(2)(3)	7,195
Retained earnings	27,333
Total stockholders' equity	51,198
Total	$2,771,198

(1) Consists primarily of long-term obligations payable to the Federal Financing Bank which are guaranteed by the Secretary of Education. See Note 4 to the Financial Statements as to interest rates and maturities.

(2) Consists of voting common stock which may only be issued to certain types of holders specified in the Act. See Note 5 to the Financial Statements. Sallie Mae is also authorized to issue non-voting common and preferred stock without ownership restrictions, but none has been issued.

(3) Adjusted for six-for-one stock split effective March 31, 1981. See Note 13 to the Financial Statements.

STATEMENTS OF INCOME AND RETAINED EARNINGS

The following statements of income and retained earnings of Sallie Mae for each of the five years in the period ended December 31, 1980 are not reported on herein by independent auditors. The information includes all adjustments which Sallie Mae considers necessary for a fair presentation of the results of operations for those periods. The statements of income and retained earnings should be read in conjunction with the financial statements appearing elsewhere in this Report.

	For the years ended December 31,				
	1980	1979	1978	1977	1976
	(Dollars in thousands except per share amounts)				
Interest income on loans:					
Insured student loans purchased	$154,059	$ 76,892	$37,023	$21,193	$12,371
Less: Net deferred income	6,468	1,823	1,075	736	257
Servicing costs	10,838	5,388	3,143	1,873	1,231
Insured student loans purchased, net	136,753	69,681	32,805	18,584	10,883
Warehousing advances	137,843	63,958	27,327	17,231	17,581
Total interest income on loans, net	274,596	133,639	60,132	35,815	28,464
Income from investments, principally interest	8,699	7,155	4,544	1,435	1,571
Total interest income	283,295	140,794	64,676	37,250	30,035
Interest expense	256,277	123,453	49,638	26,420	23,060
Net interest income	27,018	17,341	15,038	10,830	6,975
Other operating income	467	222	220	689	—
General and administrative expenses:					
Salaries and employee benefits	5,905	3,459	2,496	2,006	1,748
Other	4,219	2,381	1,346	1,069	936
Total general and administrative expenses	10,124	5,840	3,842	3,075	2,684
Income before Federal income taxes	17,361	11,723	11,416	8,444	4,291
Federal income taxes:					
Current	11,054	6,272	6,016	4,781	2,068
Deferred	(3,133)	(896)	(505)	(685)	(14)
Total Federal income taxes	7,921	5,376	5,511	4,096	2,054
Net income	9,440	6,347	5,905	4,348	2,237
Retained earnings at beginning of year	19,227	13,880	8,600	4,502	2,265
Cash dividends ($1.33, $1.00, $.63 and $.25 per share respectively)	1,334	1,000	625	250	—
Retained earnings at end of year	$ 27,333	$ 19,227	$13,880	$ 8,600	$ 4,502
Earnings per share	$9.44	$6.35	$5.90	$4.35	$2.24

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Sallie Mae had increased earnings in 1980 for the seventh consecutive year since beginning operations in 1973. Net income equalled $9.4 million or $9.44 per share, a 49% increase over 1979 results. Net income of $6.3 million in 1979 represented a 7% increase over 1978. Dividends paid to stockholders during 1980 rose to $1.33 per share, a 33% increase over 1979. Dividends of $1.00 per share paid in 1979 represented a 60% increase over the $.63 per share paid to stockholders in 1978.

Net income growth during the past two years occurred as a result of extremely large increases in Sallie Mae's program assets (loans purchased and warehousing advances). During 1980 program assets increased 83% to $2.6 billion following a 69% increase in 1979. Tight money market conditions combined with the unprecedented growth in the GSLP, a result of legislative changes in recent years, to produce these increases. These factors encouraged record use of Sallie Mae's programs by lenders.

During 1980 net interest income increased 56% to $27.0 million following a 15% increase during 1979. These increases were caused entirely by the growth in earning assets mentioned above as 1980 net interest margin declined for the third year in a row. Net interest margin is the difference between interest income, net of servicing and other operating costs, and interest expense. Net interest margins for 1980, 1979 and 1978 were 1.28%, 1.46% and 2.12%, respectively.

Several factors led to this decline in net interest margin. During 1980 several third-party servicing contracts were renegotiated requiring very large increases in fees charged as a result of inflationary pressures on the cost of these servicers' operations. In addition, the continuing inflationary pressures in the economy caused management to increase the assumption regarding future rates of inflation in servicing fees used to defer income in accordance with Sallie Mae's accounting practices. Both of these items are elements of net interest income and net interest margin for Sallie Mae. The increase in the inflation assumption decreased net interest income by approximately $2.5 million in 1980.

The decline in net interest margin during 1979 was primarily the result of the ceiling in effect during the first half of 1979 on the special allowance paid by the Federal government to all holders of guaranteed student loans. This ceiling, subsequently removed by Congress effective July 1, 1979, lowered Sallie Mae's 1979 net interest income by approximately $3 million.

An additional factor reducing net interest income and margin in both years was the change to weekly financings during 1979. Prior to this change of strategy, Sallie Mae followed a policy of financing approximately one-thirteenth of its debt requirements each week with 91-day debt obligations. While this policy served Sallie Mae well and benefitted earnings in prior years, it was anticipated that future changes in interest rates would negate the effectiveness of this procedure. Therefore, in mid-1979, Sallie Mae began rolling over all maturing debt on a seven-day basis in order to produce a much closer correlation between debt cost and earning asset rates. This change was largely responsible for maintaining profitability levels during recent periods of extreme interest rate volatility. However, the change required weekly payment of interest on Sallie Mae's debt, whereas the prior practice provided Sallie Mae with approximately a 45-day accrual of interest payable. The weekly interest payments and resulting smaller accrual increased borrowing requirements. The effect of this change served to reduce net interest income by $803,000 in 1979 and $1,910,000 in 1980.

General and administrative ("G&A") expenses have increased dramatically in response to the rapid increase in Sallie Mae's asset size and a corresponding increase in the volume of new business added per period. G&A expenses of $10.1 million in 1980 were 73% higher than in 1979, when such expenses amounted to $5.8 million, a 52% increase compared with 1978. Economies of scale, however, continue to offset the absolute dollar increase in G&A expenses. In 1978, G&A expenses represented .54% of average earning assets, while in 1979 this percentage was .49% and in 1980, .48%.

Sallie Mae's tax expense consists only of Federal income taxes since the Act exempts it from state and local taxes other than real property taxes. Since all of Sallie Mae's income is taxable for Federal corporate income tax purposes, the rate of tax used to develop the tax expense shown in the income statement is almost identical to the statutory rate legislated by Congress, which was 46% in 1980 and 1979, and 48% in 1978.

BUSINESS AND OPERATIONS

Sallie Mae has broad statutory authority to provide liquidity to banks, educational institutions and other lenders engaged in the GSLP in a manner which will increase the amount of funds available for lending under the GSLP. Sallie Mae's earnings derive primarily from the difference between (1) rates at which it is able to borrow money and (2) the effective interest rates on student loans owned by Sallie Mae and assets evidencing advances (warehousing loans) made by Sallie Mae to qualified lenders, net of servicing and other operating costs. Sallie Mae also receives fees for committing to purchase loans and to extend advances for future periods. In addition, Sallie Mae derives income from the investment of funds not immediately necessary for the implementation of Sallie Mae's programs. Sallie Mae is also authorized to sell participations or pooled interests which are secured by Federally insured or reinsured student loans, but has not yet engaged in these activities.

Sallie Mae currently offers six programs designed to facilitate lender participation in the GSLP:

1. *Loan Purchase Program.* Under the loan purchase program, Sallie Mae purchases loans directly from the student loan portfolios of eligible lenders. In addition to providing a source of liquidity for student loans, the program enables lenders to increase portfolio profitability by selling loans prior to repayment, thereby avoiding the costly and time-consuming procedures of converting loans to repayment, servicing loans and collecting payments. Funds received from the sale of student loans to Sallie Mae may be used by a lender to finance new student loan originations or to invest in other assets.

Sallie Mae believes that the characteristics of a guaranteed student loan reduce the risk of loss to Sallie Mae on the student loans which it owns. There are several sources of payment for student loans held by Sallie Mae: (i) the borrowers' obligations to repay; (ii) the Federal government's or the guarantee agencies' insurance agreements which cover defaulted loans; (iii) the Federal reinsurance agreements with the guarantee agencies; and (iv) Sallie Mae's contractual recourse to the sellers or servicing agents in the event that all or any part of the insurance or guarantee proves invalid. It is the policy of Sallie Mae to purchase only those student loans which are 100% directly insured by the United States or guaranteed by states and non-profit agencies which have agreements with the Secretary of Education for reinsurance. Sallie Mae has never experienced a loss as a result of a default on a student loan which it has purchased. For a more detailed description of the GSLP and Federal reinsurance, see "The Guaranteed Student Loan Program".

2. *Warehousing Advance Program.* Under Sallie Mae's warehousing advance program, lenders pledge existing student loan portfolios or, under recent amendments to the Act, certain types of marketable obligations issued or guaranteed by the United States or by an instrumentality thereof, as collateral for warehousing advances. Advances are made for terms up to fifteen years at either variable or fixed rates. Proceeds from warehousing advances must either be invested in new student loans or the lender must maintain the size of its student loan portfolio at the time of a borrowing at the same level throughout the term of the advance.

Warehousing advances are fully collateralized. The amount of collateral required is based upon the financial condition of the borrower and the type of security for the loan, but is never less than 100% of the amount of the advance. Sallie Mae perfects its security interest in the collateral by either taking possession and/or filing financing statements, as permitted by the Act.

3. *Seller/Servicing Program.* The seller/servicing program, initiated in January 1980, permits a lender to sell its student loans to Sallie Mae, yet retain the servicing of the loans and the customer contact inherent in the servicing relationship. The program also provides Sallie Mae with an additional source for the servicing of purchased loans.

4. *Forward Purchase Commitment Program.* Under this program, lenders are granted options to sell portfolios of student loans to Sallie Mae over a specified period of time. Forward

purchase commitments are used by some state agencies issuing student loan revenue bonds, since sales under the commitment can serve as a source of funds to repay the bonds, and thus can assist the agency in its financing activities. Forward purchase commitments can also be significant factors in encouraging institutions to participate in the GSLP for the first time, as well as encouraging large financial institutions to maintain or increase their level of student loan origination activity.

5. *Forward Financing Commitment Program.* In 1980, Sallie Mae introduced a forward financing commitment program under which Sallie Mae commits to make a warehousing advance at a future date, the proceeds of which will be used to finance student loans. Since borrowers are not required to provide collateral until the funds are actually drawn down, this program is expected to be useful to institutions participating in the GSLP for the first time.

6. *Line of Credit Program.* The line of credit program provides lenders with a convenient source of borrowing at prearranged rates. Under the program, lenders, for a fee, can draw down and repay warehousing advances, without limitation, as long as the total advances outstanding at any time do not exceed the amount of the line.

In addition to the above described programs, Sallie Mae is authorized under the Act to provide for a program of loan consolidation, to purchase parental loans, and to assist in financing student loans where there is a shortage of capital, either as a direct lender or as a source of funds to eligible state guarantee agencies or direct lenders. The loan consolidation program permits Sallie Mae to make a new loan to a borrower for the purpose of retiring the borrower's outstanding loans if certain criteria are met. It is not expected that this program will be operational earlier than the third quarter of 1981. The parental loan purchase program is still under development.

Financing

Sallie Mae obtains funds for its operations primarily from the sale of its debt securities. The Act, as amended in 1980, permits the Secretary of Education to guarantee Sallie Mae's debt obligations, regardless of maturity, issued prior to September 30, 1984. This guarantee has allowed Sallie Mae to borrow from the Federal Financing Bank ("FFB") at a relatively favorable debt cost compared to public capital markets.

On March 9, 1981, the FFB agreed to lend to Sallie Mae, from time to time at Sallie Mae's request, up to $5 billion, inclusive of currently outstanding obligations, during the period ending September 30, 1982. The Secretary of Education has provided a guarantee for notes issued prior to September 30, 1982 to the FFB for up to $5 billion outstanding at any one time. Approval from the Secretary of the Treasury is obtained by Sallie Mae as each note is issued to the FFB. As of the date of this Report, Sallie Mae had $3.445 billion of this amount outstanding, principally in the form of 15-year variable rate notes. Sallie Mae expects to utilize the entire $5 billion by September 30, 1982 by issuing additional long-term variable rate notes. The variable interest rate is determined by adding .125% to the average coupon equivalent yield of all 13-week Treasury bills sold at auctions which settled during the period between interest payment dates. For long-term notes issued to the FFB on or after March 9, 1981, interest payments are made on a semi-annual basis. For long-term notes outstanding prior to that date, interest payments are made weekly. Sallie Mae has agreed with the FFB that in the event that its average program assets during any calendar quarter are less than the aggregate principal amount of advances made pursuant to the commitment and outstanding at the end of such quarter, Sallie Mae will promptly repay such part of such advances as will cause the outstanding amount thereof not to exceed such average program assets.

Under the Act, Sallie Mae is authorized to issue, and the Secretary of the Treasury is authorized to purchase, obligations of Sallie Mae. The aggregate principal amount of such obligations which may at any time be held by the Secretary of the Treasury is $1 billion. No part of this borrowing authority has ever been utilized.

Sallie Mae intends to continue to finance a portion of its operations through the sale of debt obligations to the FFB through September 1982. In anticipation of the expiration of the Secretary of Education's authorization to guarantee Sallie Mae's obligations, Sallie Mae also intends to offer the Notes and other non-guaranteed securities to the general public during this period. The kind of securities, and the provisions thereof, which Sallie Mae may determine to offer to the general public in addition to the Notes will depend, however, upon Sallie Mae's evaluation of market conditions and the requirements of its programs from time to time.

Regulation and Reporting Requirements

The Federal government has oversight responsibilities with respect to certain aspects of Sallie Mae's activities. In addition, Sallie Mae enjoys certain exemptions from Federal and state laws. With respect to such oversight and exemptions, the Act provides, among other things, for the following:

1. One-third of Sallie Mae's twenty-one member Board of Directors is appointed by the President of the United States. The other fourteen members are elected by the stockholders. The Chairman of the Board is designated by the President.

2. Sallie Mae is exempt from all taxation by any state or by any county, municipality or local taxing authority except with respect to real property taxes. Sallie Mae is not exempt from the payment of Federal corporate income taxes.

3. All stock and other securities of Sallie Mae are deemed to be exempt securities under the laws administered by the Securities and Exchange Commission to the same extent as obligations of the United States.

4. Sallie Mae may conduct its business without regard to any qualification or similar statute in any state of the United States, including the District of Columbia, the Commonwealth of Puerto Rico and the Territories and possessions of the United States.

5. The issuance of guaranteed debt obligations of Sallie Mae must be approved by the Secretaries of Education and Treasury. The issuance of non-guaranteed debt obligations must only be approved by the Secretary of the Treasury.

6. Sallie Mae is authorized to borrow from the United States Treasury, and the Secretary of the Treasury is authorized to purchase obligations of Sallie Mae, in an aggregate principal amount of $1 billion outstanding at any one time, none of which is outstanding at the date of this Report.

7. Sallie Mae is required to have its financial statements examined annually by independent certified public accountants and to submit a report of the audit to the Secretary of the Treasury. Sallie Mae is also required to submit annual reports of its operations and activities to the President of the United States and the Congress.

THE GUARANTEED STUDENT LOAN PROGRAM

Part B of Title IV of the Act provides for the program of insured student loans known as the Guaranteed Student Loan Program. Under the GSLP, loans made by eligible lenders to students meeting the requirements of the Act may be insured by the United States or guaranteed under a student loan program of a state or private non-profit agency which has an agreement with the Secretary of Education. Loans guaranteed by state or other agencies may be reinsured by the United States. Eligible lenders include banks, thrift institutions, credit unions, educational institutions, and certain other institutions such as private, non-profit or state organizations created for the purpose of making student loans.

As an incentive for the use of private capital in providing student credit, the Act provides three principal benefits to lenders making student loans: borrower interest subsidies; "special allowance"

payments to lenders; and Federal insurance or reinsurance. These benefits are available only to eligible lenders and only for loans meeting the specific criteria of the Act. These three benefits are described below. This is only a summary of certain provisions of the Act, which has been subject to frequent amendments, and reference is made to the text of the Act for a full and complete statement of the provisions.

Interest Subsidies

The Act provides for the payment of interest subsidies by the Secretary of Education to the holders of guaranteed student loans. Such subsidies are interest payments made on behalf of student borrowers with respect to student loans (1) during the time the student is enrolled in an eligible school at least on a half-time basis; (2) during a "grace period" following termination of studies; and (3) during "deferment periods". These payments assure the lender a flow of interest income during periods when principal payments are not being made.

The Act was amended in November 1978 to provide that student loans disbursed on or after November 1, 1978 qualify for interest subsidy payments regardless of the borrower's family income level. Prior to that time, borrowers qualified for interest subsidies only on the basis of either family income level or financial need analysis.

The Secretary of Education pays the interest subsidy quarterly on behalf of the student to the holder of a student loan at the rate specified by Federal law. Student loans made before January 1, 1981 generally bear interest at 7% per annum. Loans made on or after January 1, 1981 currently bear interest at 9% per annum, except for loans made to students with outstanding 7% loans, which bear interest at 7% per annum.

Special Allowance Payments

The Act provides for "special allowance" payments to be made to holders of qualifying student loans. The special allowance is paid throughout the term of the loan. These payments are designed to supplement the fixed interest payments made by the borrowers or by the Secretary of Education in order to increase the total yield to a rate competitive with other types of investments. Since January 1, 1977, the amount of the special allowance, paid on a quarterly basis, has been computed on the basis of the bond equivalent rates of all 13-week Treasury bills auctioned during the preceding quarter, less 3.5%, rounded up to the nearest .125% of 1% and divided by four. The special allowance payments had been subject to an annual ceiling of 3% (1966-1977) and 5% (1977-1979), but statutory amendments in 1979 removed all ceilings beginning with the third quarter of 1979.

The Higher Education Act Amendments of 1980 made slight modifications to the computation of the special allowance to allow for the differences in borrower interest rates discussed above. Although generally maintaining the basic computation, the 1980 amendments require that the specific per centum subtracted from the average of the bond equivalent rates of the 13-week Treasury bills auctioned the previous quarter be 3.5% for loans for which the applicable interest rate is 7%, and 5.5% when the applicable interest rate is 9%. The special allowance, taken together with the basic interest rate paid on the student loans, therefore provides an effective interest rate approximately equal to the average coupon equivalent yield of all 13-week Treasury bills auctioned during each quarter, plus 3.5%.

Federal Insurance and Reinsurance

Student loans made by eligible lenders may be insured directly by the United States or guaranteed by a state or private non-profit agency with Federal reinsurance. Loans which are insured directly by the United States are insured up to 100% as to principal and interest. In addition,

every state agency and private non-profit agency provides lenders participating under their programs with a 100% guarantee of principal and, in most cases, interest. Substantially all of these agencies have executed the necessary agreements with the Secretary of Education to qualify for up to 100% Federal reinsurance.

The Act provides that the guarantee agency will be reimbursed in an amount "equal to 100 percent of the amount expended by it in the discharge of its insurance obligations incurred under its loan insurance program" provided that certain default levels or "triggers" are not reached. The reinsurance amount falls to 90% of the amount of current fiscal year reimbursements which exceeds 5% of the amount of loans in repayment under the program at the end of the previous fiscal year. The amount is reduced to 80% of the amount of reimbursements which exceeds 9% of the loans in repayment under the program. The reinsurance rate never falls below 80% and returns to 100% at the beginning of each fiscal year. During the first five years of a guarantee agency's operations, however, the agency is fully reinsured, without regard to the above "triggers".

The Secretary of Education is also obligated to repay the total amount owed if the student borrower dies or becomes permanently and totally disabled, or, if the loan is discharged in bankruptcy, to pay the amount of the loan discharged. With regard to a guarantee agency's reinsurance contract, these loans are not considered in determining the rate of reimbursement.

Under the Act, a student loan must be delinquent for 120 days, if it is repayable in monthly installments, before a lender may seek a default insurance payment from a guarantee agency, and the agency in turn may seek reimbursement from the Secretary of Education. Deaths, disabilities and bankruptcies, however, are not subject to the 120 day waiting period. As a prerequisite to entitlement to payment of default insurance, the lender must have exercised reasonable care and diligence in making, servicing and collecting the student loan. Standards of diligence are generally outlined by the Federal government and each guarantee agency. Sallie Mae maintains a policy of requiring that the servicing and collection procedures for loans purchased be satisfactory to the guaranteeing agency prior to the purchase of any loans under that program. In addition, Sallie Mae reviews the documentation pertaining to loans prior to their purchase to ascertain whether origination practices employed by the lender are satisfactory.

Agencies' Reserves

Sallie Mae reviews the financial situation of each guarantee agency that guarantees loans in its portfolio to determine whether the loan guarantees are adequately supported by insurance reserves. Insofar as only the Federal program and those of a small number of states are supported by "full faith and credit" provisions, such reserves may be an important source of funds to offset the possible impact of receiving less than 100% reinsurance. Specific reserve ratios are normally stated in the contract executed between lender and guarantor before the lender commences its program participation. Sallie Mae ordinarily accepts such reserve ratios; however, Sallie Mae does perform reserve depletion analyses based on historical and projected default data for purposes of assessing the risk relating to purchases of loans guaranteed by an agency. Only in situations where it has offered significant forward purchase commitments in a state has Sallie Mae required a reserve ratio in excess of the 1.5-2% generally maintained by agencies.

MANAGEMENT

The Act provides that the Board of Directors of Sallie Mae shall consist of twenty-one persons and that the Board shall determine the general policies governing the operations of Sallie Mae. Under the Act, the holders of common stock which are educational institutions elect seven of the Directors, the holders of common stock which are banks or other financial institutions elect seven of

the Directors and the remaining seven Directors, which represent the general public, are appointed by the President of the United States. The President of the United States designates the Chairman of the Board.

The present Directors and their principal occupations are as follows:

Name	Principal Occupation
Representing Financial Institutions:	
Joseph W. Barr	Partner, J. & J. Co., Champaign, Illinois (real estate partnership); Chairman, Federal Home Loan Bank, Atlanta
David B. Harper	President, Gateway National Bank, St. Louis, Missouri
Kenneth V. Larkin	Executive Vice President, Bank of America, N.T. & S.A., San Francisco, California
Charles H. Miller	Chairman of the Board. The Dime Savings Bank of New York, New York, New York
John F. Ruffle	Executive Vice President, Morgan Guaranty Trust Company of New York, New York, New York
Robert G. Stevens	Financial Consultant
David J. Vitale	Vice President and Treasurer, First Chicago Corporation, Chicago, Illinois
Representing Educational Institutions:	
William Arceneaux	Commissioner of Higher Education, Louisiana Board of Regents, Baton Rouge, Louisiana
Raymond F. Bacchetti	Vice Provost for Management and Budget, Stanford University, Stanford, California
R. Jerrold Gibson	Director, Fiscal Services, Harvard University, Cambridge, Massachusetts
William I. Ihlanfeldt	Vice President for Institutional Relations, Northwestern University, Evanston, Illinois
Ronald J. Jursa	Director, Student Financial Assistance Services, Michigan Department of Education, Lansing, Michigan
Richard J. Ramsden	Senior Vice President for Administration and Finance, Brown University, Providence, Rhode Island
David B. Truman	Educational Consultant and Retired President of Mt. Holyoke College and the Russell Sage Foundation, Hilladale, New York
Representing General Public:	
E. T. Dunlap (Chairman of the Board)	Chancellor, The Oklahoma State System of Higher Education. Oklahoma City, Oklahoma
Brenda L. Biles	Technical Assistant, Educational Issues Department, American Federation of Teachers, Washington, D.C.
Herman E. Gallegos	Chairman of the Board, U.S. Human Resources Corporation, San Francisco, California

Name	Principal Occupation
Teresa P. Hughes	Assemblywoman, California State Legislature, Sacramento, California and member, Administrative Board of Blue Shield of California
Gregory S. Nichols	Research Analyst, Iowa Senate Democratic Caucus, Des Moines, Iowa
Lois D. Rice	Senior Vice President for Government Affairs, Control Data Corporation, Washington, D.C.
Tom H. Riddell, Jr.	President, T & H Equipment Company, Inc.; partner, New Paragon Cotton Gin and Farms, Canton, Mississippi; and member of the Board of the Mississippi Bank, Jackson, Mississippi

Participants in Sallie Mae's programs are generally subject to certain requirements, including the purchase of Sallie Mae stock. Therefore, in the ordinary course of business, Sallie Mae has transactions with institutions that are stockholders and, in some cases, which have representation on Sallie Mae's Board of Directors.

At December 31, 1980, Sallie Mae had 232 employees who are engaged in various activities in connection with Sallie Mae's operations. The executive officers of Sallie Mae, the year they commenced employment with Sallie Mae and their principal occupations for the past five years are as follows:

Employee Name & Title	Year Commenced Employment	Previous Employment
Edward A. Fox President, Chief Executive Officer	1973	Mr. Fox was appointed to his current position in May 1973.
Leonard D. Schaeffer Executive Vice President, Chief Operating Officer	1980	Mr. Schaeffer was appointed to his current position in June 1980. Prior to his employment with Sallie Mae, he served in the Department of Health and Human Services as Administrator, Health Care Financing Administration (1978-1980), and as Assistant Secretary for Management and Budget (1978). Previously, he was Vice President, Citibank, N.A. (1976-1978), and Director, Illinois Bureau of the Budget, Illinois (1975-1976).
John K. Darr Senior Vice President, Chief Financial Officer	1980	Mr. Darr was appointed to his current position in May 1980. Prior to his employment with Sallie Mae, he served as Senior Vice President, Chief Financial Officer and Treasurer, Northern California Savings and Loan Association (1978-1980) and Vice President and Treasurer, Federal Home Loan Bank of San Francisco (1973-1978).
Ronald F. Hunt Vice President, General Counsel, Secretary	1973	Mr. Hunt was employed by Sallie Mae in August 1973. Prior to his current appointment in May 1979, he served as Associate General Counsel and as Secretary (1976-1979) and Assistant Secretary (1973-1976) of Sallie Mae.

DISCOUNT NOTES

Description of the Notes

The Notes are offered from time to time with maturities of one year or less (generally not less than 30 days) in denominations of $100,000, $150,000, $1,000,000 and $5,000,000. Notes are sold on a discounted basis. The discount is calculated for the actual number of days invested based on a 360-day year. Maturity dates are fixed at the time of sale, at the discretion of the buyer, subject to the general limitations prescribed by Sallie Mae. Rates are set daily by Sallie Mae. All Notes are issued in bearer-negotiable form. *The Notes are not obligations of and are not guaranteed by the United States.*

Use of Proceeds

The sale of the Notes is intended to provide an additional source of financing for Sallie Mae. The proceeds will be used for general corporate purposes.

Offering Procedure

The Notes are offered for sale to investors through a group of dealers selected by Sallie Mae. The Federal Reserve Bank of New York issues and redeems the Notes on behalf of Sallie Mae. The participating dealers have agreed to use their best efforts to maintain a secondary market for the Notes.

Tax Status

The Notes are subject to Federal estate and gift taxes and the income derived from them does not have any exemption under the Internal Revenue Code of 1954 (the "Code"). The Act does not contain any specific exemption with respect to taxes, now or hereafter imposed, on the principal of or interest on the Notes by any state, or any of the possessions of the United States, or by any local taxing authority. It is suggested that purchasers residing in states which impose intangible property or income taxes consult their tax advisers as to the status of the Notes and the interest thereon under state tax laws.

Eligibility for Investment

The Act provides that the Notes shall be lawful investments and may be accepted as security for all fiduciary, trust and public funds, the investment or deposit of which shall be under authority or control of the United States or of any officer or officers thereof. The Notes are eligible as collateral for Federal Reserve Bank "discount window" transactions. The Notes are eligible for open market purchases executed by Federal Reserve Banks.

Under Federal law, national banks and state member banks may deal in, underwrite and purchase for their own account the debt obligations of Sallie Mae. The Notes are legal investments for Federal savings and loan associations and Federal credit unions.

The Internal Revenue Service has ruled that Sallie Mae is an instrumentality of the United States for purposes of Section 7701(a)(19) of the Code. As a result, domestic building and loan associations and mutual savings banks are permitted to invest in Sallie Mae obligations to meet the percentage of total assets required to be invested in, among other things, "stock or obligations of a corporation which is an instrumentality of the United States".

Under the laws of many states, the Notes are legal for investment by savings banks, insurance companies, trustees and other fiduciaries.

CLEARING AGENT

The Clearing Agent for the Notes is the Federal Reserve Bank of New York. Denominational exchanges may be made at the Federal Reserve Bank of New York, 33 Liberty Street, New York, New York 10045.

DEALERS

The following Dealers participate in the retail sales of the Notes. These dealers have agreed to use their best efforts to maintain a secondary market for the Notes. Other dealers may also be active in the secondary market.

The First Boston Corporation
Goldman, Sachs & Co.
Salomon Brothers

LEGAL OPINIONS

Certain legal matters with respect to the issuance of the Notes have been passed upon for Sallie Mae by Ronald F. Hunt, Esq., General Counsel of Sallie Mae, and by Milbank, Tweed, Hadley and McCloy, One Chase Manhattan Plaza, New York, New York 10005, special counsel to Sallie Mae.

ACCOUNTANTS

The financial statements of Student Loan Marketing Association included herein have been examined by Arthur Young & Company, independent certified public accountants, to the extent and for the periods indicated in their report thereon. Such financial statements have been included in reliance upon the report of Arthur Young & Company and given upon the authority of that firm as experts in accounting and auditing.

12-675 O - 83 - 4

REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors and Stockholders
Student Loan Marketing Association

We have examined the accompanying balance sheets of the Student Loan Marketing Association at December 31, 1980 and 1979, and the related statements of income and retained earnings and changes in financial position for each of the three years in the period ended December 31, 1980. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statements mentioned above present fairly the financial position of Student Loan Marketing Association at December 31, 1980 and 1979, and the results of operations and changes in financial position for each of the three years in the period ended December 31, 1980, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

ARTHUR YOUNG & COMPANY

Washington, D.C.
January 16, 1981, except as to Note 13 as to
which the date is March 20, 1981

STUDENT LOAN MARKETING ASSOCIATION

STATEMENTS OF INCOME AND RETAINED EARNINGS

Years Ended December 31, 1980, 1979 and 1978

	1980	1979	1978
	(Dollars in thousands except per share amounts)		
Interest income on loans:			
Insured student loans purchased	$154,059	$ 76,892	$37,023
Less: Net deferred income	6,468	1,823	1,075
Servicing costs	10,838	5,388	3,142
Insured student loans purchased, net	136,753	69,681	32,806
Warehousing advances	137,843	63,958	27,327
Total interest income on loans, net	274,596	133,639	60,132
Income from investments, principally interest	8,699	7,155	4,544
Total interest income	283,295	140,794	64,676
Interest expense	256,277	123,453	49,638
Net interest income	27,018	17,341	15,038
Other operating income	467	222	220
General and administrative expenses:			
Salaries and employee benefits	5,905	3,459	2,496
Other	4,219	2,381	1,346
Total general and administrative expenses	10,124	5,840	3,842
Income before federal income taxes	17,361	11,723	11,416
Federal income taxes (note 8):			
Current	11,054	6,272	6,016
Deferred	(3,133)	(896)	(505)
Total federal income taxes	7,921	5,376	5,511
Net income	9,440	6,347	5,905
Retained earnings at beginning of year	19,227	13,880	8,600
Cash dividends ($1.33, $1.00 and $.63 per share respectively)	1,334	1,000	625
Retained earnings at end of year	$ 27,333	$ 19,227	$13,880
Earnings per share	$9.44	$6.35	$5.90

See accompanying notes to financial statements.

STUDENT LOAN MARKETING ASSOCIATION

BALANCE SHEETS

December 31, 1980 and 1979

ASSETS	1980	1979
	(Dollars in thousands)	
Loans (note 2):		
Insured student loans purchased, unpaid principal (note 11)	$1,230,268	$ 738,821
Less: deferred income and unearned purchase discount	13,210	6,644
Insured student loans purchased, net	1,217,058	732,177
Warehousing advances, secured by insured student loans	1,421,622	707,621
Total loans	2,338,680	1,439,798
Cash and short-term investments (note 3)	39,951	65,043
Other assets, principally interest receivable on loans and investments	103,503	50,942
Total assets	$2,782,134	$1,555,783

LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Notes payable (note 4)	$2,720,000	$1,505,000
Interest payable	2,196	3,163
Current federal income taxes	4,801	1,854
Other liabilities	3,939	2,674
Total liabilities	2,730,936	1,512,691
Commitments (notes 6 and 7)		
Stockholders' equity:		
Common stock, par value $16.67 per share; authorized 1,000,002 shares; issued and outstanding, 1,000,002 shares (notes 5 and 13)	16,670	16,670
Additional paid-in capital	7,195	7,195
Retained earnings	27,333	19,227
Total stockholders' equity	51,198	43,092
Total liabilities and stockholders' equity	$2,782,134	$1,555,783

See accompanying notes to financial statements.

STUDENT LOAN MARKETING ASSOCIATION

Statements of Changes in Financial Position

Years Ended December 31, 1980, 1979 and 1978

	1980	1979	1978
	(Dollars in thousands)		
Sources of Funds:			
From operations:			
Net income	$ 9,440	$ 6,347	$ 5,905
Add net non-cash charges consisting principally of net deferred income and deferred taxes	3,550	1,082	595
Total funds provided from operations	12,990	7,429	6,500
Increase in notes payable	1,215,000	600,000	450,000
Matured warehousing advances and principal payments on non-matured advances	97,172	58,336	58,486
Principal reductions on insured student loans purchased:			
Installment payments	58,246	33,084	20,855
Claims and resales	45,034	19,712	21,285
Increase in interest payable	—	—	4,914
Decrease in cash and short-term investments	25,092	28,712	—
Increase in current federal income taxes payable	2,946	—	—
Other	—	—	1,834
Total sources of funds	$1,456,480	$747,273	$563,874
Uses of Funds:			
Matured long-term notes payable	$ —	$ 10,000	$ 50,000
Warehousing advances made:			
New loans	784,973	311,541	182,490
Renewed loans	26,200	40,450	48,493
Insured student loans purchased	594,535	348,760	209,919
Increase in cash and short-term investments	—	—	61,238
Increase in interest receivable	47,996	28,061	10,260
Decrease in interest payable	967	6,725	—
Decrease in current federal income taxes	—	69	849
Cash dividends paid	1,334	1,000	625
Other	475	667	—
Total uses of funds	$1,456,480	$747,273	$563,874

See accompanying notes to financial statements.

STUDENT LOAN MARKETING ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

December 31, 1980

1. Significant Accounting Policies

The Student Loan Marketing Association (Sallie Mae) is a private, for-profit corporation created and authorized by Congress to serve as a national secondary market for the Guaranteed Student Loan Program (GSLP) and the Health Education Assistance Loan (HEAL) Program.

A description of Sallie Mae's significant accounting policies follows:

(a) Loans

Insured student loans purchased are stated at their unpaid principal balance net of related deferred income and unearned purchase discount. Warehousing advances are stated at their unpaid principal balance.

(b) Income Recognition on Insured Student Loans Purchased

Interest on insured student loans purchased is recognized as income in the period it accrues adjusted for accretion of purchase discounts and, as described below, for income deferred to offset future servicing costs.

Servicing costs, which are charged to expense as incurred, are generally based upon an amount per borrower or per note serviced and the status of the account. As a result, servicing costs as a percentage of principal balance increase over the terms of the loans. Under Sallie Mae's policy, current interest income is deferred or previously deferred income is recognized so as to provide a constant yield over the estimated remaining terms to maturities of the loans. Estimates of the remaining terms to maturities and other factors are used to determine adjustments to current income, and the effect of changes to such estimates are reflected prospectively in income over the remaining terms of the loans.

(c) Allowance for Possible Loan Losses

Insured student loans purchased by Sallie Mae are guaranteed by the Secretary of Education, by the Secretary of Health and Human Services or by a state or private nonprofit guarantee agency with which the Secretary of Education has an agreement under the Higher Education Act of 1965, as amended (the Act), provided applicable program requirements are met with respect to such loans. Additionally, the selling institutions warrant that the student loans are the valid obligations of student borrowers. Warehousing advances are secured by an assignment of existing insured student loans with an aggregate outstanding principal balance of at least 125% of the outstanding advance amount. Accordingly, at December 31, 1980, 1979 and 1978, no allowance for possible loan losses was deemed necessary.

(d) Short-term Investments

Investments are carried at cost which approximates market, adjusted for amortization of premiums and accretion of discounts.

(e) Federal Income Taxes

Sallie Mae recognizes certain income and expense items in different periods for financial reporting purposes than for income tax purposes. Provision for deferred income taxes is made in recognition of these timing differences. Investment tax credits which were not material in 1980, 1979 or 1978, are accounted for by the flow-through method.

STUDENT LOAN MARKETING ASSOCIATION

NOTES TO FINANCIAL STATEMENTS—(Continued)

December 31, 1980

2. Loans

(a) Insured Student Loans Purchased

Student borrowers begin repayment of loans on an installment basis after a grace period of nine to twelve months following graduation or loss of qualified student status. The repayment period, generally five to ten years, is negotiated with the borrower during the grace period. In addition to a stated interest rate of 7%, a special allowance is paid by the Secretary of Education to eligible holders of guaranteed student loans. The special allowance will be the average coupon equivalent yield of all 13-week U.S. Treasury bill auctions conducted during each quarter, less 3.5%, rounded up to the nearest one-eighth of 1%. Prior to July 1, 1979, a ceiling of 5% for any four consecutive calendar quarters existed for the payment of the special allowance.

(b) Warehousing Advances

Warehousing advances are secured loans with specified maturities and fixed or variable-rates of interest made to eligible institutions. The interest rates on variable rate advances are indexed to the 13-week U.S. Treasury bill interest rate. A summary of warehousing advance maturities follows (dollars in thousands):

Maturing in:	December 31 1980	1979
1980-1984	$ 372,712	$312,961
1985-1989	817,660	163,410
1990-1994	231,250	231,250
Total	$1,421,622	$707,621

3. Cash and Short-term Investments

Funds not currently required to finance programs were invested in money market instruments as follows (dollars in thousands):

	December 31 1980	1979
Federal funds sold	$34,300	$43,350
Securities purchased under agreements to resell	5,006	20,437
Cash	645	1,256
Total cash and short-term investments	$39,951	$65,043

4. Notes Payable

Under the Act, the issuance of debt obligations requires the approval of the Secretaries of Education and Treasury. Payment of Sallie Mae's debt obligations, regardless of maturity date, issued prior to October, 1984 may be guaranteed by the Secretary of Education, and any such guaranteed debt obligations are backed by the full faith and credit of the United States. As a matter of administrative convenience, rather than issue individual certificates for each debt obligation sold by Sallie Mae, it has been the practice of the Secretary of Education to issue a single guarantee certificate for a stated period of time covering all such debt obligations up to a specified amount at any one time outstanding. This amount is subject to change in accordance with program needs. The

STUDENT LOAN MARKETING ASSOCIATION

NOTES TO FINANCIAL STATEMENTS—(Concluded)

December 31, 1980

11. GSLP Regulations

The insured student loans Sallie Mae owns are subject to certain regulations of general applicability issued by the Department of Education (ED) with respect to the administration of the GSLP. In November, 1980, Sallie Mae received for comment a draft report based on a program review by ED which alleged certain deficiencies in Sallie Mae's compliance with GSLP regulations. A final report which will reflect comments, corrections and additional information provided by Sallie Mae is not expected to be issued until the second quarter of 1981. It is not possible to predict the outcome of the program review, but management believes that it will not have a material effect on the financial statements.

12. Quarterly Financial Information (Unaudited)

Unaudited quarterly financial information for the years ended December 31, 1980 and 1979 are summarized as follows (dollars in thousands, except per share amounts):

	1980				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Interest income	$65,080	$56,171	$63,118	$98,926	$283,295
Interest expense	58,906	51,875	55,360	90,136	256,277
Net interest income	6,174	4,296	7,758	8,790	27,018
Other operating income	91	113	133	130	467
General and administrative expenses	1,914	2,349	2,442	3,519	10,124
Federal income taxes	1,990	986	2,412	2,533	7,921
Net income	$ 2,361	$ 1,174	$ 3,037	$ 2,868	$ 9,440
Earnings per share	$2.36	$1.17	$3.04	$2.87	$9.44

	1979				
Interest income	$27,089	$28,838	$35,970	$48,897	$140,794
Interest expense	22,403	26,761	31,021	43,268	123,453
Net interest income	4,686	2,077	4,949	5,629	17,341
Other operating income	38	52	55	77	222
General and administrative expenses	1,274	1,467	1,470	1,629	5,840
Federal income taxes	1,576	303	1,614	1,883	5,376
Net income	$ 1,874	$ 359	$ 1,920	$ 2,194	$ 6,347
Earnings per share	$1.87	$.36	$1.92	$2.19	$6.35

13. Subsequent Event

On March 20, 1981 the Board of Directors of Sallie Mae approved a six-for-one split of Sallie Mae's outstanding common stock, effective March 31, 1981. As a result, the number of outstanding shares was increased from 166,667 shares (par value $100) to 1,000,002 shares (par value $16.67). The stock split resulted in a transfer of $3,333 from additional paid-in capital to common stock. All per share amounts and other share information have been restated to reflect this transaction.

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

December 9, 1981

TO : Honorable Jennings Randolph
Attention: Mrs. Kyle

FROM : American Law Division

SUBJECT: Questions Regarding Recent Amendments, Enacted and Proposed, to the Student Loan Marketing Association Provisions of the Higher Education Act of 1965, 20 U.S.C. §1087-2(1).

This memorandum is in response to various questions which you have posed to David Osman, analyst in the Education and Public Welfare Division, Congressional Research Service, regarding the legal effect of amendments to the Student Loan Marketing Association (Sallie Mae) provisions of the Higher Education Act of 1965, Pub. L. No. 89-329, §439(1), as added by Pub. L. No. 92-318, §133, as amended, 20 U.S.C. §1087-2(1). The amendments in questions are those enacted in the Omnibus Budget Reconciliation Act of 1981 (OBRA), Pub. L. No. 97-35, §538 (d) and agreed to by the House of Representatives November 20, 1981. 127 Cong. Rec. H8716 (daily ed. Nov. 20, 1981). After some preliminary discussion of the legislation at issue, we will answer the questions in the order Mr. Osman presented them to us.

It is our understanding that the Student Loan Marketing Association is a private, shareholder-owned corporation that provides liquidity to participants in the Guaranteed Student Loan Program. Created by Congress in 1972, the organization was originally characterized as a "Government-sponsored private corporation." Pub. L. No. 92-318, §133. The Association's organizing statute was amended in 1980 to deem Sallie Mae a "private corporation." Pub. L. No. 96-374, §421(a). While Congress originally intended that the corporation be financed by private capital, Pub. L. No. 92-318, §133, the organization has apparently

funded its operations since 1974 by selling guaranteed debt obligations to the Federal Financing Bank (FFB).

The planned shift by the Association from government to public financing has prompted the introduction of amendments dealing with the disposition of the Association's assets (or the repayment of its debt) in the case of insolvency. The amendment enacted in OBRA, §538(d) provides the following:

> (d) Section 439(1) of the Act is amended by adding at the end thereof the following: "The obligations of the Association shall be deemed to be obligations of the United States for purposes of section 3701 of the Revised Statutes (31 U.S.C. 742). For the purpose of the distribution of its property pursuant to section 726 of title 11, United States Code, the Association shall be deemed a person within the meaning of such title.".

Because of perceived defects in the OBRA amendment, an additional Sallie Mae amendment was proposed and agreed to by the House in November 1981. Proponents of the measure maintained that the Federal priority statute, 31 U.S.C. §191, which grants the Federal government a priority over all other creditors whenever any person indebted to the United States is insolvent (as defined by the statute), made the nonguaranteed discount notes that Sallie Mae planned to offer in the public market unattractive to potential borrowers. 127 Cong. Rec. H8716 (daily ed. Nov. 20, 1981). The November 20 amendment thus amends 20 U.S.C. §1087-2(1) to provide that "[t]he priority established in favor of the United States by section 3466 of the Revised Statutes (31 U.S.C. 191) shall not apply to indebtedness of the Association." Ibid.

You have asked whether 31 U.S.C. §191 actually operates to "subordinate all of Sallie Mae's public borrowing to the debts owed the FFB," an effect described by Mr. Simon during debate on the proposed amendment. 127 Cong. Rec. H8716. Were Sallie Mae to become insolvent in the manner required by 31 U.S.C. §191, but not proceed as a debtor under the Federal bankruptcy statute, 11 U.S.C. §101

et seq., then 31 U.S.C. §191 would appear to grant the United States an absolute priority right to the Association's assets, subject to certain conditions. Except in the case of a decedent's estate, the priority statute requires that the debtor's insolvency be evidenced by a voluntary assignment, the attachment of the estate and effects of an absconding, concealed or absent debtor, or the commission of an act of bankruptcy, even though a bankruptcy proceeding does not follow. United States v. Oklahoma, 261 U.S. 253, 262 (1923); Plumb, "The Federal Priority in Insolvency: Proposals for Reform," 70 Mich L. Rev. 3, 12-14 (1971) [hereinafter cited as Plumb]. In such case, certain judicial limitations placed on the operation of the priority statute might also apply. E.g., Epstein & Landers, Debtors and Creditors 324-326 (1978). We note, however, that the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, §322, made the Federal priority statute inapplicable in cases under 11 U.S.C. §§101 et seq. Thus, if Sallie Mae were to proceed as a Title 11 debtor, its Federal unsecured debt would no longer be subject to the §191 priority. As stated in the legislative history of the 1978 Act, "the government's non-tax claims [would be] on a par with other unsecured claims, unless ... the government's claim is secured." H.R. Rep. No. 595, 95th Cong., 1st Sess. 194 (1977).

You have also asked whether the OBRA amendment affects the application of the priority statute, and, in particular, what effect results from designating Sallie Mae as a "person" under Title 11 for purposes of 11 U.S.C. §726, and whether such designation has the same effect as that intended by the November 20 amendment. We find that the OBRA amendment appears to be unclear in its intended effect. It would seem that the drafters may have desired that Sallie Mae be considered a person for purposes of Chapter 7 of the Bankruptcy Act, that is,

that it be enabled to file for a liquidation. In such case, one might question why the provision limits the application of chapter 7 to the provision dealing with distribution of the estate, that is, §726.

An amendment to the definition of "person", 11 U.S.C. §101(30), or "governmental unit," 11 U.S.C. §101(21), might have been clearer, this bringing into play 11 U.S.C. §109, dealing with who may be a debtor under the various chapters of the bankruptcy code. Only "persons" may qualify as debtors under chapter 7 (liquidation) and chapter 11 (reorganization), provided they fulfill the other requirements of the bankruptcy code. 11 U.S.C. §109(a), (b), (d). The code definition of person" includes individuals, partnerships, and corporations, but excludes governmental units. 11 U.S.C. §101(30). As "governmental unit" is defined to include a "department, agency, or instrumentality of the United States," 11 U.S.C. §101 (21), it could be argued that Sallie Mae, as a government-created corporation, would not be deemed a person for purposes of the bankruptcy code. In such case, an amendment to the code would be needed in order to enable Sallie Mae to proceed as a Title 11 debtor. However, it could also be argued that, because Sallie Mae is now apparently a private corporation, 20 U.S.C. §1087-2(a), it would seem to fall within the definition of "person" under 11 U.S.C. §101(30). In addition the definition of "governmental unit" is intended not to include "entities that owe their existence to State action such as the granting of a charter or a license but that have no other connection with a State or local government or the Federal government. The relationship must be an active one in which the department, agency, or instrumentality is actually carrying out some governmental function." H.R. Rep. No. 598, 95th Cong., 1st Sess. 311 (1977). Were Sallie Mae to be considered in this light, the Association would appear to be subject to Title 11 whether or not another statute provided the same.

We note again that it appears that the drafters of the OBRA amendment intended that Sallie Mae be authorized to file for liquidation under the bankruptcy code.* The effect of the November 20 amendment appears to broaden the existing Title 11 exemption from 31 U.S.C. §191, by making the Federal priority statute inapplicable in any case of Sallie Mae insolvency, not only where proceedings under Title 11 were involved.

You have also asked what effect the November 20 amendment has on the Federal priority in the event of bankruptcy. Were Sallie Mae to become a Title 11 debtor, the amendment would have no effect, as the Federal priority for unsecured non-tax claims has already been eliminated in the Bankruptcy Reform Act of 1978.

Finally, you have asked if the Federal government would be giving up any other legal "rights" besides the priority right in bankruptcy if the November 1981 amendment were to become law and, in particular, if there are any other hidden legal "pitfalls" in treating public debt on a par with private debt in the event of bankruptcy. The November 1981 amendment, as noted above, would remove the Federal priority set forth in 31 U.S.C. §191 from all insolvency proceedings contemplated by §191 and not merely from title 11 proceedings. The amendment concerns only the Federal priority right, but increases the number of situations in which Sallie Mae's indebtness will be exempt from the right.

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* The legislative history of the amendment is unclear as it merely states that the legislation intends that "Sallie Mae obligations ... [be] considered as governmental obligations for the purposes of bankruptcy proceedings." H.R. Rep. No. 208, 97th Cong., 1st Sess. 742-43 (1981). The amendment contains two provisions: one, making Sallie Mae obligations exempt from state and local taxation under 31 U.S.C. §742; two, deeming Sallie Mae a person within the meaning of Title 11 for the purpose of distribution of its property pursuant to 11 U.S.C. §726. OBRA, §539(d). The Statement in the House Report appears to combine both provisions of the amendment, instead of dealing separately with what would seem to be the different effects of each.

Eliminating the exemption does not appear to have any other legal implications in terms of bankruptcy law. We note that in deciding to treat Federal unsecured non-tax claims on a par with private unsecured claims, Congress appeared to be responding to a growing body of thought that the Federal government, as a knowing lender, should be subject to the same risks undertaken by private lenders. See, e.g., Plumb 10-12; H.R. Rep. No. 595, 95th Cong., 1st Sess. 193-94 (1977).

We hope that this information will be helpful to you, and that you will call on us if you have any additional questions.

Jeanne Jagelski
Legislative Atttorney

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

LEGISLATIVE HISTORY OF

THE STUDENT LOAN MARKETING ASSOCIATION

Mark Wolfe
Analyst in Education
Education and Public Welfare Division
May 17, 1982

PROVIDED AT THE REQUEST OF
SENATOR JENNINGS RANDOLPH

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BACKGROUND AND SUMMARY

Section 439 of the Higher Education Act of 1965, as amended, authorizes the Student Loan Marketing Association (Sallie Mae) to provide secondary market and related activities for qualified lenders participating in the Guaranteed Student Loan (GSL) program and in the Health Education Assistance Loan (HEAL) program. Sallie Mae is also authorized by section 439 to purchase and underwrite student loan revenue bonds, provide GSLs in States where they are not available from other sources, and offer extended repayment terms to GSL and HEAL borrowers.

The purpose of Sallie Mae, as originally erected by the Education Amendments of 1972 (P.L.92-318), was to provide liquidity to GSL lenders through two secondary market activities: (1) through purchases of GSLs from lenders' portfolios, and (2) through "warehousing advances" (loans) to lenders, with lenders using GSLs as collateral to obtain funds from Sallie Mae to make additional student loans.

Prior to the enactment of the 1972 Amendments, the volume of GSL lending had increased rapidly from $77 million in 1966 (when the first loans were issued) to nearly $1.1 billion in 1971. As the volume of program lending increased, GSL lenders, many of whom had accumulated relatively large portfolios of student loans, became increasingly reluctant to commit additional funds for GSLs because of their relative lack of liquidity, long repayment schedules and relatively high servicing costs. By comparison, home mortgages at the time were viewed by the lenders as more favorable investments because they could be sold

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to investors or to the Federal National Mortgage Association (Fannie Mae), thus providing liquidity.

While both the final House and Senate versions of the 1972 amendments supported the establishment of the Student Loan Marketing Association, the initial Senate version, S.659, as introduced by Senator Pell and as reported by the Subcommittee on Education, Arts, and the Humanities, would have only authorized secondary market activities for GSLs in the Department of Treasury rather than via a separate agency. Senator Pell reportedly was concerned that the establishment of a new agency would commit the Federal Government to financing higher education primarily through loans.

Significant changes were made to section 439 by the Health Professions Educational Assistance Act of 1976 (P.L. 94-484), Education Amendments of 1980 (P.L. 96-374), and the Omnibus Budget Reconciliation Act of 1981 (P.L. 97-35). Minor technical changes were provided by the Education Amendments of 1976 (P.L. 94-482) clarifying Sallie Mae's authority to take possession of student loans pledged as collateral for warehouse advances. The Health Professions Act of 1976 authorized Sallie Mae to provide warehouse and purchasing services for HEAL borrowers. The 1980 amendments provided that Federal securities, in addition to GSLs, could be used as collateral for warehouse advances; authorized Sallie Mae to consolidate and extend repayment terms for GSL borrowers; and provided that Sallie Mae could insure loans to borrowers in certain circumstances where substantial numbers of students were unable to obtain loans from program lender.

The Omnibus Budget Reconciliation Act of 1981 authorized the Association to provide secondary market services for non-insured student loans, consolidate loans for HEAL borrowers, purchase and underwrite student loan bond issues

and carry out any other activities determined by the Board of Directors to support the credit needs of students.

Lastly, the Older Americans Act of 1981 (P.L. 97-115) amended section 439 by providing (through September 30, 1982), that all creditors, including the Federal Government, would have equal priority to Sallie Mae's assets, if Sallie Mae were to seek relief in case of financial distress by any means other than voluntary liquidation. The intent of this amendment was to improve the acceptance by investors of Sallie Mae's non-guaranteed obligations by placing all of Sallie Mae's debt obligations on an equal footing under all possible bankruptcy arrangements.

This paper describes the initial amendments to the Higher Education Act in 1972 that established Sallie Mae, and the subsequent amendments to the original legislation enacted in 1976, 1980, and 1981. Copies of the amendments to the Higher Education Act relating to Sallie Mae and the relevant House and Senate Committee report sections concerning the amendments, are included as an appendix at the end of this paper.

GLOSSARY OF SELECTED TECHNICAL TERMS

Guarantee Agency--A State agency or private non-profit agency that administers the Guaranteed Student Loan program in the State.

Guaranteed Student Loan Program--A Federal program providing financial assistance in the form of interest subsidized loans to undergraduate, graduate, and professional students who are enrolled, on at least a a part-time basis, at participating colleges, universities, or vocational/technical schools. As of October 1, 1981, GSLs are based on financial need for families whose adjusted family income exceeds $30,000.

Health Education Assistance Loan Program--A Federal program providing financial assistance in the form of loans to full time students attending schools of medicine, osteopathy, veterinary medicine, podiatry, public health, and pharmacy. Students receiving a HEAL award may not receive any other federally insured loan for the year covered by the HEAL award. HEAL awards do not carry a Federal interest subsidy.

Secondary Market--A means by which loan notes can be sold or pledged as collateral for additional funds from one party to another. Sallie Mae provides two secondary market functions: (1) through purchases of GSLs from lenders portfolios; and (2) through "warehousing advances" (loans) to lenders using GSLs as collateral to obtain funds from Sallie Mae to make additional student loans.

Student Loan Revenue Bonds--Tax exempt obligations issued by guarantee agencies to raise funds to provide GSLs for students who are unable to receive student loans for commercial borrowers and in some cases to also purchase GSLs made by program lenders . In 1981, $1.4 billion in student loan bonds were issued by 20 guarantee agencies.

LEGISLATIVE HISTORY

Education Amendments of 1972 (P.L. 92-318)

P.L. 92-318 authorized the establishment of Sallie Mae as an amendment to the Higher Education Act of 1965, Title IV, part B, section 439; described as follows:

Purpose

The purpose of Sallie Mae is to serve as a secondary market and warehousing facility for insured (GSL) student loans and to provide liquidity for student loan investments.

Warehousing and Purchasing Authority

Sallie Mae is authorized to purchase, service, sell, and make warehouse advances on insured loans. Warehouse advances can be made to qualified lenders for 80 percent of the face value of their insured loans which must be invested by the lender in additional insured loans. The Association is authorized only to purchase from, or make warehouse advances to, qualified lenders that provide assurances that they will not require that students or their families maintain a business relationship with them as a prerequisite for receiving a GSL. (This provision does not apply, however, to lenders with less than $50 million in deposits.) In addition, lenders cannot discriminate against GSL applicants on the basis of race, sex, color, creed or national origin.

Capital Structure and Financing Authorities

Sallie Mae is authorized to issue common stock with a par value of $100 per share to qualified lenders and institutions. Each share of common stock will have one vote with rights of cumulative voting (one vote per share) for Board elections. The Secretary of HEW is authorized to prepare regulations concerning the transfer and number of shares issued of common stock. 1/ Sallie Mae is also authorized, with the approval of the Secretary, to issue preferred non-voting stock, with a par value of $100.

Sallie Mae is authorized, with the approval of the Secretary of the Treasury and the Secretary of HEW, to issue and have outstanding, through July 1, 1982, obligations guaranteed by the Secretary of HEW. The aggregate amount of such obligations is to be determined by the Secretary of HEW in consultation with the Secretary of Treasury.

Board of Directors

The Board is responsible for making overall policy for Sallie Mae including the criteria for providing advances on securities and purchasing of student loans. It is comprised of 21 members of which: 7 are elected by eligible lenders; 7 are elected by eligible educational institutions; and 7 are appointed by the President. The Chariman of the Board is appointed by the President from among the 21 board members.

1/ P.L. 96-88, which established the U.S. Department of Education, changed all references to the Secretary of HEW, which applied to programs administered by the newly enacted Department of Education, to the Secretary of Education.

The duties of the Chairman include calling, at least semi-annually, the meetings of the Board, and selecting, with the approval of the Board, the executive officers for Sallie Mae. 2/

Reports

Sallie Mae is required to prepare and submit annually to the President and the Congress, a report describing its operations and activities. The Secretary of the Treasury is required to prepare and submit annually to the President, the Congress, and the Secretary of HEW a report describing the annual audit of Sallie Mae.

Other Provisions

The amendments provided for the general corporate powers, audit requirements, and procedures for ending program operations. The amendments also provided that Sallie Mae would maintain its primary offices in the District of Columbia, and that its assets, except for its real estate assets, would be exempt from State and local taxation.

2/ P.L. 92-318 authorized the President to appoint an interim Board of Directors for Sallie Mae to arrange for an initial offering of common and preferred stock and take whatever other actions would be necessary to proceed with the operations of Sallie Mae. The amendments also authorized the Secretary of HEW to loan $5 million, at an interest rate determined by the Secretary of the Treasury, to assist in the establishment of the Association.

Summary of Congressional Action

House Reports: No. 92-554 accompanying H.R. 7248 (Committee on Education and Labor) and No. 92-1085 (Committee of Conference)

Senate Reports: Nos. 92-346 and 92-604 (Committee on Labor and Public Welfare) and No. 92-798 (Committee of Conference)

Congressional Record:
Vol. 117 (1971): Aug. 4-6, considered and passed Senate
Nov. 3, 4, considered and passed House, amended, in lieu of H.R. 7248

Vol. 118 (1972): Feb. 22-25, 28, 29, Mar. 1, Senate agreed to House amendment with amendments
Mar. 8, House disagreed to Senate amendment; requested a conference
May 23, 24, Senate agreed to conference report
June 8, House agreed to conference report
June 23, signed into law by the President

Education Amendments of 1976 (P.L. 94-482)

The 1976 amendments authorized Sallie Mae to take possession of student loans pledged as collateral for warehouse advances.

--Previous law did not contain a similar provision.

Summary of Congressional Action

House Reports: No. 94-1085 accompanying H.R. 12835, No. 94-1086 accompanying H.R. 12851 and No. 94-1232 accompanying H.R. 14070 (all from Committee on Education and Labor) and No. 94-1701 Labor) and No. 94-1701 (Committee of Conference)

Senate Report No. 94-882 (Committee on Labor and Public Welfare)
Congressional Record, Vol. 122 (1976):
Aug. 26, 27, considered and passed Senate
Aug. 31, considered and passed House, amended, in lieu of H.R. 12835, H.R. 12851, and H.R. 14070
Sept. 28, Senate agreed to conference report
Sept. 29, House agreed to conference report
Oct. 12, signed into law by the President

Health Professions Educational Assistance Act of 1976 (P.L. 94-484)

New Authorities

Sallie Mae is authorized to purchase, service, sell and make warehouse advances on loans insured through the Health Education Assistance Loan (HEAL) program.

Summary of Congressional Action

House Reports: No. 94-266 (Committee on Interstate and Foreign Commerce) and No. 94-1612 (Committee of Conference)

Senate Reports: No. 94-886 (Committee on Labor and Public Welfare) and No. 94-887 accompanying S. 3239 (Committee on Labor and Public Welfare)

Congressional Record:
Vol. 121 (1975): July 11, considered and passed House
Vol. 122 (1976): July 1, considered and passed Senate, amended
Sept. 20, Senate agreed to conference report
Sept. 27, House receded and concurred in Senate amendment with amendment
Sept. 30, Senate agreed to House amendment
Oct. 12, signed into law by the President

Education Amendments of 1980 (P.L. 96-374)

Warehousing and Purchasing Authority

Those amendments authorized Sallie Mae to provide warehouse advances to qualified lenders for up to 100 percent of the face value of: GSLs; securities or marketable obligations issued, guaranteed, or insured by the Federal Government; and marketable obligations issued, guaranteed, or insured by any agency, instrumentality or corporation of the Federal Government. The amendments required that lenders receiving a warehouse advance must either reinvest an amount equal to the advance in additional insured loans or maintain a level of insured loans equal to the amount of the advance.

Previous law required that GSLs could only be used for warehouse advances for 80 percent of their face value. Other U.S. securities or guaranteed securities could not be used as collateral for such advances. In addition, previous law required that all such advances must be reinvested in additional insured loans.

These amendments authorized Sallie Mae to purchase from, or make warehouse advances to, qualified lenders with assets of less than $75 million in deposits who require that students or their families maintain a business relationship with the lender as a prerequisite for receiving a GSL.

Previous law provided that Sallie Mae could purchase from or make warehouse advances to, lenders with less than $50 million deposits who required students or their families to maintain a business relationship with them as a prerequisite for receiving a student loan.

These amendments also clarified the authority of the Association to resell, offer participations or pooled interests secured by insured loans.

Capital Structure and Financing Authority

The Board of Directors is authorized to issue common and non-voting common and preferred stock. The amendments provided that the Board would determine the volume and par value of any such stock issued.

Previous law required the Secretary of Education to prescribe regulations concerning the amount of common and preferred stock issued, approve any proposal to issue preferred stock, and set the par value of any stock issued at $100 per share. In addition, previous law did not authorize the issue of non-voting common stock.

The amendments extended Sallie Mae's authority to issue obligations guaranteed by the Secretary of Education through October 1, 1984. 3/

The Secretary of the Treasury is authorized to purchase up to $1 billion in any non-guaranteed securities offered by Sallie Mae.

The Secretary of Education can only disapprove obligations issued by Sallie Mae which are guaranteed by the Secretary.

Previous law provided that the Secretary could disapprove the issue of both guaranteed and non-guaranteed obligations issued by the Sallie Mae.

New Authorities

The amendments authorized Sallie Mae, or its agent, to act as a direct lender to make consolidated or extended repayment insured loans to borrowers who have insured loans from more than one lender in excess of $7,500 or from one lender in excess of $5,000. The amendments provided that Sallie Mae may designate a State student loan guarantee agency as its agent under this part.

Sallie Mae is authorized, upon approval by the Secretary, and in consultation with and the agreement of a representative of the State agency, to make direct loans to borrowers in States where there are substantial numbers of students who are unable to obtain insured loans from commercial lenders.

Sallie Mae is authorized, with the approval of the Secretary, in States that have not established a guarantee agency or an agency to act as a direct lender to students unable to obtain insured loans from commericial lenders, to act as a direct lender to those students.

3/ Sallie Mae which has funded its operations primarily through obligations guaranteed by the Secretary of Education through the Federal Financing Bank (FFB) entered into an agreement on March 1, 1981, with the Secretary of Education and the Secretary of the Treasury to cease using FFB funds on September 30, 1982, or when the total FFB borrowing reaches $5.0 billion.

Sallie Mae is authorized to provide advances and to set the repayment terms, to any agency or eligible lender that would be unable to make GSLs without such assistance.

Summary of Congressional Action

House Report: No. 96-520 (Committee on Education and Labor) and No. 96-1337 (Committee of Conference)

Senate Report No. 96-733 accompanying S. 1839 (Committee on Labor and Human Resources)

Congressional Record:
Vol. 125 (1979): Oct. 29, Nov. 2, 7, considered and passed House
Vol. 126 (1980): June 23, S. 1839 considered in Senate
June 24, H.R. 5192 considered and passed in lieu of S. 1839
Aug. 28, House agreed to conference report
Sept. 4, Senate rejected conference report
Sept. 18, House agreed to second conference report
Sept. 25, Senate agreed to second conference
Oct. 3, signed into law by the President

Omnibus Budget Reconciliation Act of 1981 (P.L. 97-35)

Purpose

The Reconciliation Act authorizes Sallie Mae to serve as a secondary market and warehouse facility for non-insured (non-Federal) student loans and to assure nationwide coverage of loan insurance.

Previous law only authorized Sallie Mae to serve as a secondary market and purchasing authority for insured student loans.

Warehousing and Purchasing Authority

Sallie Mae is authorized to deal in obligations issued by State agencies or eligible lenders.

Previous law did not authorize the Association to deal in obligations issued by State agencies or eligible lenders.

Capital Structure and Financing Authority

Sallie Mae is authorized to insure GSLs in States where the Department of Education determines that loan demand is not being met by the established State agency, or where there is no State agency willing or able to provide GSLs.

Previous law only authorized Sallie Mae to make direct loans in areas where the Department of Education in consulation with and agreement of the State agency that loan demand is not being met by commerical lenders.

The Board of Directors is authorized to undertake any other activity which it determines to be in furtherance of programs of either insured or uninsured student loans, or that otherwise support the credit needs of students.

Previous law did not contain a similar provision.

Sallie Mae's obligations are to be considered as Government obligations for the purposes of bankruptcy proceedings.

Previous law did not contain a similar provision.

Sallie Mae is authorized to consolidate loans for HEAL borrowers.

Previous law only authorized Sallie Mae to purchase, service, sell and make warehouse advances on loans made by program lenders.

Summary of Congressional Action

House Reports: No. 97-158, vols. I-III (Committee on the Budget) and No. 97-208 bks. 1, 2 (Committee of Conference)

Senate Report: No. 97-139 accompanying S. 1377 (Committee on the Budget)

Congressional Record, Vol. 127 (1981):
June 22-25, S. 1377 considered and passed Senate
June 25, 26, considered and passed House
July 13, considered and passed Senate, amended in lieu of S. 1377
July 31, House and Senate agreed to conference report
Aug. 13, signed into law by the President

Older Americans Act Amendments of 1981 (P.L. 97-115)

Capital Structure and Financing Authority

These amendments provided that all creditors (through September 30, 1982) would have equal priority to Sallie Mae's assets if Sallie Mae were to seek relief in case of financial distress, by any areas other than voluntary liquidation. The apparent intent of this amendment was to improve the acceptance by investors of Sallie Mae's non-guaranteed obligations by placing all of Sallie Mae's debt obligations on an equal footing under all possible bankrupt arrangements.

Previous law provided that the Federal Government would have first priority access to any of Sallie Mae's assets unless Sallie Mae were to seek a voluntary liquidation under the Federal bankrupt statutes.

Summary of Congressional Action

House Reports: No. 97-70 accompanying H.R. 3046 (Committee on Education and Labor) and No. 97-386 (Committee of Conference)

Senate Report: No. 97-159 (Committee on Labor and Human Resources)

Congressional Record, Vol. 127 (1981):
Nov. 2, considered and passed Senate
Nov. 20, H.R. 3046 considered and passed House; proceedings vacated and S. 1086, amended, passed in lieu
Dec. 11, Senate agreed to conference report.
Dec. 16, House agreed to conference report

Description of Sallie Mae Services

Major

1. Loan Sale Program --- Sallie Mae purchases loans from a lender's GSL portfolio.
   Benefits to lenders:
   1) Source of liquidity
   2) Increase portfolio profitability

2. Warehousing Advance Program--- Lenders borrow from Sallie Mae against the security of their outstanding GSL portfolio (during 1981, Sallie Mae accepted obligations issued by U.S. as collateral for a warehousing advance)
   Benefits to lenders:
   1) Convenient source of loan funds to meet increasing student loan demand

Other

3. Forward Purchase Commitment Program --- Lenders have the option to sell portfolios of student loans to Sallie Mae, and Sallie Mae is obligated to purchase a specified amount of student loans over a specified period of time. Attractive to State agencies issuing student loan revenue bonds as a source of funding for guaranteed student loans. The commitment can assist the agency in obtaining a more favorable bond rating by assuring bondholders that funds will be available for meeting future principal and interest payments.

4. Forward Financing Commitment Program --- Sallie Mae makes a commitment to lend funds to lenders at a future date for financing student loans. Lenders are not required to provide collateral until funds are drawn down.

5. Line of Credit Program --- Lenders, for a fee, can draw down and repay funds without limitation, as long as the total outstanding at any one time does not exceed the amount of the line.

6. Seller/Servicing Program --- Permits lenders to sell student loans to Sallie Mae while retaining the responsibility for servicing the loans under a fee arrangement. Attractive to high-volume GSLP lenders who have made a substantial commitment to the establishment of effective student loan servicing systems.

7. Loan Consolidation Program (OPTIONS) --- Enables borrowers with high student loan indebtedness to refinance an outstanding student loan by obtaining a new longer-term guaranteed student loan from Sallie Mae.

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Sallie Mae Options (Consolidated) Loans

Volume New Loans

FY 1982	#	$
1st QTR	158	1,834,002.79
2nd QTR	474	5,757,383.27
	632	$ 7,591,386.06

- Options' Interest Rate 7%
- Average Consolidated loan $ 12,011.69
- Average Option's loan period 13 years

Source of Loans Consolidated under OPTIONS:

FY 1982	GSL	NDSL
1st QTR	$ 1,627,693.54	$ 206,309.25
2nd QTR	5,274,037.02	483,346.25
	6,901,730.56	$ 689,655.50
% of $	91%	9%

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Sallie Mae Financing Highlights

Since 1974, Sallie Mae has met all of its debt needs thru Federal Financing Bank (FFB) borrowings. However, in March 1981, Sallie Mae agreed to discontinue further FFB borrowings, either at the time that outstanding FFB debt reached $5 billion or by September 30, 1982. This decision was consistent with the Administration's desire to reduce federal credit activities. The final take down of FFB funds occurred in January 1982. A summary of Sallie Mae's $5 billion debt to FFB by maturity year is as follows:

1986-1995; $30 million annually	$ 300 million
1995	2.650 billion
1996	1.650 billion
1997	400 million
	$5.000 billion

In May 1981, Sallie Mae began offering discount notes, with maturities of up to one year, through selected securities dealers. During 1981, sales of discount notes totalled $4.5 billion. At year-end (Dec. 31, 1981), discount notes outstanding totalled $419 million.

In February 1982, Sallie Mae issued its first 3-year floating rate note of $250 million. This floating rate note proved immediately attractive to investors seeking relief from interest rate volatility, because the interest rate is reset weekly based upon auction yields on 91-day U.S. Treasury bills.

During 1982, Sallie Mae expects to sell approximately $1 billion in floating rate notes to fund new student loan assets (loan purchases and warehousing advances) and will continue selling discount notes for cash flow purposes.

Summary of New Loans Purchased by Sallie Mae

Under its Loan Purchase Program

M=Million; B=Billion
Year = Calendar year

	1974	1975	1976	1977	1978	1979	1980	1981	thru 12/31/81
New Loans Purchased	$4.2 M	$67.2 M	$131.3 M	$92.0 M	$209.9 M	$348.8 M	$594.5 M	$1.042 B	$2.490 B
Outstanding Year End	$4.2 M	$70.9 M	$197.1 M	$271.4 M	$438.1 M	$732.2 M	$1.217 B	$2.094 B	

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Summary of Warehousing Advances Made by Sallie Mae

Under its Warehousing Advance Program

	1973	1974	1975	1976	1977	1978	1979	1980	1981	thru 12/31/81
Warehousing Advances During Year	$75.9 M	$155.4 M	$169.2 M	$89.1 M	$158.2 M	$234.0 M	$352.0 M	$811.2 M	$1.410 B	$3.452 B
Outstanding at Year End	$75.9 M	$191.6 M	$235.8 M	$214.0 M	$241.5 M	$414.0 M	$707.6 M	$1.422 B	$2.755 B	

At December 31, 1981, Sallie Mae's investment in student loans, consisting of warehousing advances outstanding and insured loans purchased, was equal to approximately 25% of all GSLP loans outstanding.

STUDENT LOAN MARKETING ASSOCIATION
COMMITMENTS SUMMARY
DECEMBER 31, 1981

Prepared for Department of Education

	Commitments To Purchase	Lines of Credit	Total
Commitments Approved and Executed	$1,159,450,000	$406,550,000	$1,566,000,000
Takedowns/Exercises	(252,500,307)	(384,011,000)	(636,511,307)
Commitments Outstanding	$ 906,949,693	$ 22,539,009	$ 929,488,691

Forecasted Commitment Activity	Commitments To Purchase	Lines of Credit	Total
Date			
01/01 - 01/31/82	$ 80,000,000	$ 20,000,000	$ 100,000,000
02/01 - 02/28/82	56,000,000	-0-	56,000,000
03/01 - 03/31/82	30,000,000	-0-	30,000,000
Total	$ 166,000,000	$ 20,000,000	$ 186,000,000

Claims Paid to Sallie Mae

FY	FISL	GA	TOTAL
80	$24.2 M	$8.4 M	$32.6 M
79	$21.5 M	$3.1 M	$24.6 M
78	No Call Report		
77	$1.1 M	$.9 M	$2.0 M

Source: Call Report Data

STUDENT LOAN MARKETING ASSOCIATION
MONTHLY SUMMARY OF NEW STUDENT LOANS PURCHASED
WAREHOUSING ADVANCES AND COMMITMENTS
As of DECEMBER 1981

Prepared for the Department of Education

	Loan Purchase Program		Warehousing Advance Program		Total	
	Transactions	Amount	Transactions	Amount	Transactions	Amount
Commercial Banks	72	$ 79,068,288	---	$ -0-	72	$ 79,068,288
Savings and Loans	26	73,107,093	5	36,490,000	31	109,597,093
Credit Unions	8	2,939,969	2	500,000	10	2,939,969
Educational Institutions	---	-0-	---	-0-	---	-0-
State Agencies/ State Direct Lenders	2	13,482,581	---	-0-	2	13,482,581
Total	108	$168,057,888	7	$36,990,000	115	$205,047,888

PORTFOLIO BALANCE BY INSTITUTION TYPE
As of December 31, 1981

	Loan Purchase Program	Warehousing Advance Program	Commitments To Purchase	Lines of Credit	
				Unused Portion	Gross Amount If Repaid
Other Institutions, principally financial	$1,800,660,850	$2,703,405,251	$202,949,693	$22,539,000	$374,050,000
State Agencies and State Direct Lenders	168,736,054	625,000	704,000,000	-0-	-0-
Educational Institutions	128,905,700	50,884,726	-0-	-0-	32,500,000
Total	$2,098,302,604	$2,754,914,977	$906,949,693	$22,539,000	$406,550,000

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STUDENT LOAN MARKETING ASSOCIATION

OUTSTANDING DEBT SUMMARY AS OF 01/07/82

NUMBER		ISSUE DATE	MATURITY DATE	AMT ISSUED (000 OMITTED)	PROCEEDS	FIRST COUPON DATE	NEXT COUPON DATE	COUPON INTERVAL IN MONTHS	DAYS TO MATURITY	COUPON EQUIVALENT YIELD	EFFECTIVE ANNUAL RATE
FFB	277	11/18/80	11/14/95	$2,000,000	$2,000,000,000	11/25/80	01/12/82	.23	5059	12.3045	N/A
FFB	295	12/30/80	12/26/95	$ 650,000	$ 650,000,000	01/06/81	01/12/82	.23	5101	12.3045	N/A
FFB	298	01/13/81	01/09/96	$ 950,000	$ 950,000,000	01/21/81	01/12/82	.23	5115	12.3045	N/A
FFB	301	03/31/81	03/29/96	$ 100,000	$ 100,000,000	09/29/81	03/29/82	6.00	5195	VARIABLE	N/A
FFB	303	04/07/81	04/05/96	$ 200,000	$ 200,000,000	10/05/81	04/05/82	6.00	5202	VARIABLE	N/A
FFB	306	04/21/81	04/19/96	$ 100,000	$ 100,000,000	10/19/81	04/19/82	6.00	5216	VARIABLE	N/A
FFB	314	07/01/81	07/01/96	$ 300,000	$ 300,000,000	01/04/82	07/01/82	6.00	5309	VARIABLE	N/A
FFB	315	07/16/81	07/16/96	$ 100,000	$ 100,000,000	01/18/82	01/18/82	6.00	5308	VARIABLE	N/A
FFB	316	08/05/81	08/05/96	$ 100,000	$ 100,000,000	02/05/82	02/05/82	6.00	5329	VARIABLE	N/A
FFB	317	08/14/81	08/14/96	$ 100,000	$ 100,000,000	02/16/82	02/16/82	6.00	5333	VARIABLE	N/A
FFB	318	08/27/81	08/27/96	$ 100,000	$ 100,000,000	03/01/82	03/01/82	6.00	5346	VARIABLE	N/A
FFB	319	09/16/81	09/16/96	$ 100,000	$ 100,000,000	03/16/82	03/16/82	6.00	5366	VARIABLE	N/A
FFB	320	09/23/81	09/23/96	$ 100,000	$ 100,000,000	03/23/82	03/23/82	6.00	5373	VARIABLE	N/A
FFB	321	10/01/81	SERIAL[1]	$ 300,000	$ 300,000,000	04/01/82	04/01/82	6.00	3455	VARIABLE	N/A
FFB	322	01/07/82	01/07/97	$ 400,000	$ 400,000,000	07/07/82	07/07/82	6.00	5479	VARIABLE	N/A

$ YTD AVERAGE COST COUPON EQUIVALENT YIELD:	12.3045
$ YTD AVERAGE MATURITY IN DAYS:	5065
TOTAL AMOUNT OUTSTANDING:	$ 5,000,000,000
CUMULATIVE AMOUNT ISSUED:	$149,440,000,000

1 First Maturity 10/1/86 for $30 million.

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Contractors Sallie Mae uses to service its Student Loan portfolio

1. Academic Financial Services Corp., a subsidiary of First Chicago Corp.
2. Student Loan Servicing Center of the First National Bank of Minneapolis.
3. Wachovia Services, Inc., a subsidiary of Wachovia Corp.
4. Bank of America
5. Pennsylvania Higher Education Assistance Authority
6. Unipac Services Corp. (OPTIONS)
7. Student Loan Repayment Center, Fairfax, Va.
8. Student Loan Repayment Center, Sallie Mae (in-house)
9. United Student Aid Funds, Inc. (USAF)
10. Computer Services Inc. (CSI)
11. Massachusetts Higher Education Assistance Corp.
12. Wisconsin Higher Educational Aids Board
13. Connecticut Student Loan Foundation

Senator RANDOLPH. Off the record.

[Discussion off the record.]

Senator STAFFORD. Thank you, Senator.

I would note that our first panel is at the witness table, and looking at both of the panels, the Chair notes that we have both a Fox and a Hawk here today, which means it is lucky there are no chickens in the room.

The first witness will be Mr. Edward A. Fox, president, Student Loan Marketing Association, to be followed by Mr. Edward A. McCabe, chairman of the board of the same association, both of Washington.

Mr. Fox?

Mr. Fox. Mr. McCabe will precede me. Thank you, Senator.

Senator STAFFORD. Mr. McCabe will go first, all right.

STATEMENT OF EDWARD A. McCABE, CHAIRMAN OF THE BOARD, STUDENT LOAN MARKETING ASSOCIATION, WASHINGTON, D.C., AND EDWARD A. FOX, PRESIDENT AND CHIEF EXECUTIVE OFFICER, STUDENT LOAN MARKETING ASSOCIATION, WASHINGTON, D.C.

Mr. MCCABE. Thank you, Mr. Chairman. I appreciate your opening comments, and I particularly appreciate those of Senator Randolph. This is a large, a complex and growing financial institution. I am delighted to hear the extent of the research and the work that has been done and is underway at the staff level here to develop a better understanding of these operations.

It is important that you know about us, and we want you to know about us, and to the extent these hearings can help in that regard, we are doubly delighted.

Senator STAFFORD. Would you be willing to pull the mike up a little closer, Mr. McCabe, please?

Mr. MCCABE. I was appointed chairman of this board by the President in November 1981, and this was a particularly pleasing appointment to me because I had been the organizing chairman of this company back in 1972 and served as chairman of the board of directors for the first 6 years until late 1978.

As has been said, Sallie Mae is a private, for-profit corporation, so established by Congress 10 years ago. It provides a secondary market and a warehousing facility for lenders to make guaranteed loans to students. Its mission generally is to support student credit.

I think it is important to keep in mind that it is owned by its shareholders. It pays dividends to those shareholders and it pays substantial Federal taxes. The corporation that I left, Mr. Chairman, in 1978 at the end of my term as chairman is very different from the one I returned to in 1981.

In 1978, Sallie Mae's total assets were less than $1 billion, and now they total $6.5 billion. The Warehousing Advance Program—the one by which money is loaned to institutions to make student loans—provided $182.5 million in calendar year 1978, and in 1981 it was up to $1.4 billion.

The Loan Sale Program—the one by which Sallie Mae buys existing loans from lenders—had a portfolio in 1978 slightly over $500 million, and in 1981 it had grown to $2 billion. In 1978, Sallie Mae

dealt with over 200 lenders, and now deals with over 1,300 lenders nationwide.

We believe the corporation has kept pace with the growth in the guaranteed student loan program. In addition to the growth in assets I just mentioned, it has grown in complexity as well, implementing numerous new programs that provide liquidity to lenders and support the guaranteed student loan program. The community lender program, the seller servicing program, the Government securities advance program, and the loan consolidation program are a few examples of these.

In addition, and quite importantly, in this past year Sallie Mae has raised all its operating funds in the public capital markets, thereby providing funds to support the Guaranteed student loan program from private, nongovernmental sources. I am happy to report that Sallie Mae's debt offerings have been well received in the marketplace. I believe Sallie Mae has shown through its growth and diversity the viability of support for a social program by a private corporation.

The Board of Directors of Sallie Mae was designed by Congress to direct policy for the corporation. The Board is made up of all outsiders; there are no employee directors. The day-to-day operations of the company are left to management under the direction of Mr. Edward A. Fox, the President of Sallie Mae, who is here with me.

However, the Board takes very seriously the mandate of the Higher Education Act that Sallie Mae is designed specifically to support student credit. All policy decisions on the direction of Sallie Mae's program are made by the Board, which weighs carefully the needs of the guaranteed student loan program in creating and administering these programs.

Sallie Mae's 21-member Board represents the diversity of the guaranteed student loan program itself. Seven public directors appointed by the President come from backgrounds of banking, insurance, the legal profession, business and education.

The voting stock of Sallie Mae may, by statute, be owned only by financial and educational institutions that participate in the guaranteed student loan program. Seven directors are elected by educational institutions that are stockholders. These educational directors come from private and public colleges and from state agencies. The seven directors elected by the financial institutions that are stockholders come from all types of financial institutions, large and small, and thri[illegible] institutions as well.

Sallie Mae is [illegible]harged with the responsibility of responding to the needs of the gu[illegible]anteed student loan program. To this end, the Board has prescribed a range of programs to respond to the varying needs of different types of lenders, and to respond quickly to changes in the guaranteed student loan program.

Mr. Chairman, with that very quick overview, I will ask our President and Chief Executive Officer, Mr. Edward A. Fox, to my right here, to discuss current corporate programs, and then he and I will try to answer any questions you may have.

Senator STAFFORD. Thank you very much, Mr. McCabe.

Mr. Fox, we would be glad to hear from you.

Mr. FOX. Thank you, Senator. It is a particular pleasure to be introduced by Ed McCabe because he hired me as the first employee

of Sallie Mae 9 years ago when this was just an idea, a piece of legislation that had been approved by the Congress. It was a corporation that had a great deal of potential but absolutely no assets, no income, and not even a place to sit.

In the last 9 years, we have built this corporation to $6.5 billion. To give you an idea of just how it might compare with other institutions, that would make Sallie Mae the equivalent of about the 35th or 40th largest bank in the United States—$6.5 billion worth of assets, all of which assets are totally employed in the pursuit and support of the guaranteed student loan program.

These programs include loan programs, purchase programs, and commitment programs, putting up a very significant amount of money in support of the underlying GSLP and more modest-sized loan programs established by the Congress.

The support that we have given in all of these programs is equal to approximately 30 percent of all the dollars totally committed today to the GSLP. If you were to take the programs that support housing, you would find that our one organization provides proportionately more credit than all of the combined secondary markets in support of housing on a nationwide basis. So, we feel that we have had a very positive and very supporting impact in both the growth and support and management of the guaranteed student loan program.

There are one or two other comments I would like to make before returning it to you, sir, for questions. The thrust and trend of the corporation over the last few years, by congressional attitude and by necessity, has been to make this a more conservative entity because you have asked us to become a totally private corporation, to finance ourselves in the private capital markets, to break whatever connections that we do have with the Federal Financing Bank and with the Federal Government, and to learn to be a self-sufficient entity and a tax-paying entity that builds itself on the basis of its balance sheet, its earning statement, and through its ability to raise capital in support of these programs in the private capital markets without using any tax resources as appropriated by the Congress.

We are doing that and we are doing so at a higher cost, absorbing much of it. We are trying very hard to continue to provide service as a private corporation, dependent on our ability as a successful business to attract capital.

Under our statute we are subject to audit by the Treasury Department since inception, we have been providing the Department with appropriate information for their review.

In terms of our earnings, we make less than one-half of 1 cent per dollar on the assets that we hold. And we find that if we were to compare ourselves with the 100 largest banks in the banking system, while we would be approximately the 35th largest bank in the country, our earnings would be at the very bottom of the list of those institutions.

We would find that our Federal tax rate would be the highest of any of the 100 largest banks in the United States. We would find that our return on assets would be one of the lowest. We would find that our capital, proportionate to our size, would be just about the lowest.

We feel that we have to survive on the strength of that balance sheet in order to attract capital and provide service in support of the guaranteed student loan program. And with the direction of the board of directors, which is representative of the entire student loan program, we are moving to try to manage consistent with the needs of all the constituencies in higher education in support of the guaranteed student loan program.

Senator, that ends my statement. We have given you a great deal of material, and hopefully we do not have to repeat all of that, for the record.

Senator STAFFORD. Thank you very much, Mr. Fox. We will place your entire statement in the record as if read.

[The prepared statement of Mr. Fox and joint responses of Mr. McCabe and Mr. Fox to questions asked by Senators Hatch, Randolph, and Stafford, follow:]

TESTIMONY OF

EDWARD A. FOX

STUDENT LOAN MARKETING ASSOCIATION

The Student Loan Marketing Association (Sallie Mae) is a private, for-profit corporation chartered by Congress to provide a national secondary market for insured student loans made by private or state lenders under the federally-sponsored Guaranteed Student Loan Program (GSLP) and Health Education Assistance Loan Program (HEAL).

By law, Sallie Mae is structured along traditional corporate lines, with total responsibilities in the hands of a board of directors and a management team. The President of the United States appoints one-third of the 21-member board and designates the chairman from among the full membership. By statute, financial and educational institutions are permitted to own shares of voting stock of the corporation and each group elects one-third of the board of directors.

Sallie Mae provides a broad spectrum of private and state lenders--commercial banks, thrift institutions, credit unions, state agencies and other lenders--with a source of liquidity. It offers such lenders the opportunity to sell student loans at cash value or to borrow additional funds to support their student lending activity by pledging existing

loans as collateral, thus serving as a secondary market for student loans.

In 1980, amendments to the basic enabling legislation, the Higher Education Act of 1965, enlarged Sallie Mae's statutory program and financing authority. Specific provisions authorize the corporation to consolidate or refinance student loans, to lend funds directly to state agencies where there is a certified shortage of loan capital, and to serve as a direct lender in states where there is a severe student loan shortage. Various amendments were included in the Omnibus Budget Reconciliation Act of 1981 broadening Sallie Mae's authorities as a prospective "safety net" in support of student credit. These include the right to purchase student loan revenue bonds and, with the approval of the Secretary of Education, to be an insurer under certain specific and limited conditions. A detailed discussion of these amendments can be found in the Appendix to this testimony.

In nine years of operation, Sallie Mae has provided more than $7.5 billion of support to lenders under the GSLP. As of July 31, 1982, its investment of $5.6 billion in the GSLP was equal to approximately 30 percent of all insured student loans outstanding. This compares favorably with the experience of all government-sponsored housing secondary market activities which

have ranged between 15 and 24 percent during the past five years.

Sallie Mae has worked with 1,300 lenders providing direct or indirect financial assistance to millions of students in 51 states and territories. They include commercial banks, savings banks, thrift institutions, credit unions, educational institutions, state agencies and state secondary markets. It has assisted in financing statewide programs in 17 states and the District of Columbia.

Sallie Mae obtains funds for its operations primarily from the sale of its debt obligations. In recent years it has financed its activities principally through the issuance to the Federal Financing Bank (FFB) of debt obligations guaranteed by the Secretary of Education. As announced by Secretary Regan on May 7, 1981, Sallie Mae has begun borrowing in the public markets without the guarantee of the federal government.

The corporation is expected to meet the same profit and loss standards, including a return on stockholders' equity, as a business without a government link. It pays full federal income taxes and has received no federal appropriations during its entire history. Sallie Mae has severed its ties with the federal government in connection with its funding activities. Its objective is to achieve its primary social purpose of expanding credit in support of access to postsecondary education

by operating as a business organization subject to the disciplines and opportunities of the marketplace. As such, Sallie Mae considers itself to be a prototype for transforming a quasi-government organization into a private sector corporation that functions efficiently and profitably while fulfilling its original public service purpose.

During 1981, Sallie Mae provided $2.5 billion of secondary market support for the GSLP, a dramatic increase over the $1.4 billion in 1980. During the year the corporation's holdings of student loan related assets increased by 86 percent over 1980. From December 31, 1977, through June 30, 1982, the corporation has grown approximately 12 fold from $500 million to over $6.1 billion. Sallie Mae purchased $1 billion of guaranteed student loans in 1981, representing over 1,400 transactions from institutions in almost every state in the union. During 1982, Sallie Mae expects to increase moderately its dollar volume of loan purchases against the 1981 performance. Warehousing advances (loans) totalled $1.4 billion in 1981, a dramatic increase over the $811 million made available in 1980. This growth was caused by lessened liquidity in the banking system and high interest rates which, in combination, create a cyclical demand for loans from Sallie Mae. Lowered interest rates and the previous utilization of available collateral by lending institutions suggest that demand for this service from

Sallie Mae will diminish substantially in 1982. Over $500 million of lending ir the Warehousing Advance Program in 1981 was against collateral other than student loans. This authority, first contained in the 1980 amendments to the Higher Education Act, permitted Sallie Mae to finance institutions that had not previously participated in the GSLP and permitted others that were lenders-of-last-resort to borrow from Sallie Mae to assure access to eligible students. Additionally, Sallie Mae provided $800 million of commitments to 58 institutions in 1981 to either purchase loans or lend at a future point in time. As of June 30, 1982, such commitments which are contingent liabilities of the corporation, totalled nearly $900 million.

Sallie Mae was given the responsibility in the 1980 amendments to put in place a Loan Consolidation Program for certain qualifying students relative to the National Direct Student Loan Program (NDSL) and the GSLP. Approval from the Department of Education was not forthcoming until late in 1981, resulting in a pilot program first being offered during the fourth quarter. Because of the lack of a usable data base to identify prospective candidates for loan consolidation, and due to an extremely time consuming and costly process of origination, results of our pilot program are just beginning to become available. A preliminary response from high indebtedness graduates suggests a relatively modest interest in the loan consolidation opportunity. However, Sallie Mae is committed to providing loan

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consolidation to all qualified students.

Under current law, all consolidated loans must bear interest at the rate of seven percent. Statutory authorization is required to make loans bearing interest at nine percent in cases where the GSLP loans being consolidated bear that rate. We have informed the Department of Education that we will not actively solicit nine percent loans for consolidation at seven percent and will welcome legislation to allow nine percent consolidations.

Another program provided to Sallie Mae in the 1980 amendments clarified Sallie Mae's ability to lend directly to states. The Department of Education has taken the position that states borrowing from Sallie Mae on a direct basis would qualify for only a half special interest allowance. Many states have approached Sallie Mae during these difficult times in the student loan revenue bond markets, seeking financing from Sallie Mae. The interpretation given to Sallie Mae's authority by the General Counsel of the Department of Education, however, has prevented Sallie Mae from providing this assistance. Resolution of this issue is a critical necessity for the viability of programs in many state lending agencies.

Most state agencies have financed their GSL Programs with the sale of three-year tax-exempt revenue bonds. The student loans acquired by the agencies will have a life that is considerably longer. To the extent that refinancing is prohibitively expensive or that legislation either limits or excludes

the issuance of student loan revenue bonds, it is clear that the states must find alternative funding.

The Department of Education has suggested that as an alternative Sallie Mae pursue becoming a direct lender in those states in which demand cannot be satisfied through a Loans to States Program. Sallie Mae would prefer to deal in wholesale rather than retail programs but, more importantly, with a strong existing structure of established state guarantee agencies, it seems to us inappropriate to by-pass or replicate these institutions in providing retail services in their states. We are gratified that the majority and minority leadership of the House and the Senate communicated with the Secretary of Education that the Department's position was inconsistent with the intent of the original statute. If there is to be a viable Loans to States Program, the Congress is going to have to amend the statute--and we leave that to your judgment.

During the past three years, Sallie Mae has provided a secondary market in support of the HEAL Program. Because of increased demand for HEAL loans in 1982 and reduced participation by the banking system, Sallie Mae has provided capital in support of a lender-of-last-resort program to assure that all qualified prospective borrowers are able to obtain a loan. This program was put in place following consultation and with the support of the Department of Health and Human Services, bankers and the

appropriate educational institutions.

Various questions have arisen as to the purpose of amendments to the Sallie Mae provisions in the Omnibus Budget Reconciliation Act of 1981, and the activities of Sallie Mae since enactment of these provisions. These amendments were designed such that if the Act's changes to the GSLP resulted in a reduction in lender participation, alternatives would be available for student credit. In fact, the Conferees specifically said that with regard to certain provisions "the authority given Sallie Mae is only stand-by authority." H.R.Rep.No.208, 97th Cong. 1st sess. 743(1981). Sallie Mae has not yet exercised any of the new authorities provided in the Act. In addition, two of the Sallie Mae amendments were designed to correct deficiencies in the language enacted in the Education Amendments of 1980 relative to Sallie Mae's financing in the private capital markets. You should be aware that recently a small number of institutions have identified groups of middle income students who are no longer eligible for the GSLP and have approached Sallie Mae for discussions relative to a secondary market for uninsured student loans. Sallie Mae is examining its appropriate role in supporting student financing through non-federal loan programs.

We are appreciative of the support of the Congress in providing a technical amendment to Sallie Mae's enabling statute

in 1981 which provided that "[t]he priority established in favor of the United States by section 3466 of the Revised Statutes (31 U.S.C. 191) shall not establish a priority over the indebtedness of the Association issued or incurred on or before September 30, 1982." This amendment has created a temporary waiver as it is limited to debt issued or incurred prior to September 30, 1982. We believe that this limitation should be removed before that date so that Sallie Mae will continue to be able to finance its activities, to fund outstanding commitments, and to fulfill its congressional mandate of providing liquidity to the student loan market.

The most significant single development in the financial area during 1981 was the negotiation of an agreement with Administration officials in March that set the basic course of Sallie Mae's funding activities in the future. In exchange for an additional $2 billion of long-term financing authority at the FFB (bringing the total of such borrowing authority to $5 billion) the corporation agreed to accelerate the time schedule for re-entry into the capital markets to fund its activities. Specifically, the agreement called for Sallie Mae to end its borrowing from the FFB by September 30, 1982, or at the time a total of $5 billion of such borrowings was outstanding. Sallie Mae also agreed to enter the capital markets without the use of the full faith and credit guarantee of the Department of

Education which was originally available until October 1, 1984. Working in concert with the Treasury Department, this agreement provides a sound base for Sallie Mae to begin financing its program acquisitions without federal support, as intended by Congress. Sallie Mae will rely heavily on the public markets to fund its operations in 1982, as only $400 million of additional FFB borrowing was available at the end of 1981 and has since been taken down.

Sallie Mae began its reintroduction to the public capital markets in May, 1981, by issuing short-term discount notes. The notes have been well received by investors, often trading at lower yields than those offered by other agencies. Through June 30, 1982, more than $10 billion of discount notes had been sold and redeemed and $403 million were outstanding at that date.

The corporation intends to rely on intermediate-term, variable-rate debt, rather than on short-term discount notes, in spite of the somewhat higher costs anticipated from this strategy. It is important to maintain a conservative approach to managing Sallie Mae's affairs, given the corporation's high debt-to-equity ratio. The corporation's ratio was 70 to 1 on June 30, 1982, as compared to ratios of between 18 and 15 to 1 for the three largest banking institutions in Washington, D.C., on that date. An instrument has been structured to protect Sallie Mae from certain risks, as the index for the interest rate and the timing of the change of interest rate are virtually

the same as those of the corporation's program assets. In addition, a Sallie Mae Management task force has been established to evaluate the feasibility of issuing a security in the form of a student loan pass-through or participation certificate. Also, renewed efforts have been initiated to assess the opportunities for an equity issue.

It is also possible that Sallie Mae will enter the Eurocredit markets in 1982 with a modest sized debt issue to introduce the corporation's name to that potentially valuable source of liquidity. Although such an issue is unlikely to be indexed to U.S. Treasury bills, it is expected that being prepared for proper market execution will enable the corporation to tap this market at a propitious time and at a reasonable cost. Preliminary planning for this financing is already underway.

Under its enabling legislation, Sallie Mae is subject to federal income taxes as a private, for-profit corporation. Taxes on its 1981 income, both current and deferred, were $14.9 million. Through 1981, Sallie Mae has incurred total tax liability of $42 million. After provision for taxes, 1981 corporate earnings were $18.0 million. Dividends of $1.5 million (eight percent of earnings) were paid to our stockholders. The remainder was retained by the corporation and invested in further support of student loans.

Adherance to current and prospective regulatory interpretations and law by those responsible for servicing

requires constant attention to detail and a commitment of meaningful dollars. It is essential that all parties be aware of the continual risks that servicing represents to the entire student loan system.

Servicing continues to be the most serious issue for Sallie Mae and other major holders of guaranteed student loans. During 1981, Sallie Mae increased from 5 to 10 the number of contract servicers acting as agent to collect its loans and actively entered the servicing business itself. By July 31, 1982, Sallie Mae was collecting at its own service center on over $200 million of student loans, or approximately seven percent of the $2.8 billion of student loans owned. The corporation has developed its own software system at considerable expense and expects to have that system fully tested and functioning during 1982, enhancing its collection capability and efficiency. Student loan servicing continues to be plagued by a lack of commonality among the requirements of the various guarantors which results in a plethora of differing routines in the collection system for each state. Hopefully, some method will be developed for encouraging uniformity where differences are not truly warranted. Other problems related to cost are brought about by frequent legislative change. For example, recent statutory changes have created 7 percent and 9 percent loans, and the possibility of 8, 12, and 14 percent loans. This increases accounting and data processing costs. Other changes having to do with deferment, grace period, minimum repayment,

eligibility, and the rounding or lack of rounding of the special allowance to the nearest higher eighth of a percent, have required the separation of loans for different treatment and, in some cases, even the separation of the loans of a single borrower. This further complicates the system and increases costs. For a large holder of student loans, a combination of circumstances relative to an individual student can require some enormously complex solutions. The process is additionally impaired by the rigidity with which regulations are interpreted, often differing in each of the 10 federal regions. I would hope that the Congress takes note of the operational aspects of any proposed changes in the GSLP so that the intent of the change can be managed within the framework of the existing banking system.

Changes in the banking and financial services industry could have an impact on the GSLP. We anticipate continued movement towards interstate banking and a continuance of interstate and interindustry mergers. This trend is accompanied by continued expansion of financial services which will require a considerable amount of systems and data processing support. We are not convinced that the financial industry is willing to commit large dollar amounts or to give first priority for changes and development of student loan systems. We are also aware of the banking system's lack of interest in the parent loan program, primarily because of the high costs associated

with immediate collection, operational problems, the impact on other lending, and the probability of change.

Another concern has to do with the deteriorated condition of the municipal bond market. The major participants as buyers have been commercial banks and insurance companies during the last twenty years. Commercial banks have significantly reduced their appetite for municipal bonds as other forms of tax-reducing transactions, such as leasing, have become available to them. Casualty insurance companies as a group are less profitable and so have less income to shelter through the purchase of tax-free securities. That puts the burden on individuals and, since the 1981 tax legislation has reduced the maximum tax rate on unearned income from 70 percent to 50 percent, tax-free securities are less attractive. The result is a significant increase in the cost of marketing municipal bonds and, quite specifically, the cost of issuing student loan revenue bonds. This year one major state paid about 13 percent, all costs included, for a 10-year bond issue. To the extent that the market does not improve, many states who provide primary and secondary market services in support of the GSLP will have difficulty in continuing to provide service to eligible students and institutions. We are aware that this source of financing is under consideration this week in the conference on the tax bill.

Sallie Mae will also be faced with considerably higher

costs of funds in 1982, financing itself in private capital markets without the full faith and credit of the United States. There is also a question as to the amount of funds which will be available to Sallie Mae in the marketplace. Systems development and control costs and servicing fees as discussed earlier will also add to Sallie Mae's expenses. The reduced availability of funds, the high cost, and higher operating expenses will, in all probability, result in a changing role for Sallie Mae proportionate to the GSLP.

The cost of funds to financial intermediaries, state agencies, and Sallie Mae is a function of the marketplace and will have to be managed in a sophisticated and, hopefully, in a successful manner by each institution. But, the costs associated with regulation and system development and collection can be improved through simplification of the underlying GSLP program, and we would welcome any move in that direction.

Thank you very much, Mr. Chairman, for the opportunity to present these comments.

QUESTIONS FROM SENATOR HATCH

1. You state your return on assets is low and that you are at a disadvantage with respect to other competitors in the private credit market. Has this disadvantage been reflected in a higher cost to you in that market or in greater difficulty in moving your bond issues than others experience?

Over the last five years, Sallie Mae's return on assets has declined from .89 percent in 1977 to .46 percent, on an after federal income tax basis. Information published by the American Banker indicates that Sallie Mae's 1981 ROA performance would rank the corporation in the lowest quartile when compared with major U.S. commercial banks. It is essential that the corporation improve this key ratio to further stimulate investor confidence and support. Traditionally, well-managed, large commercial banks have a 75 to 100 basis point ROA. While Sallie Mae first sold its securities in 1973 and 1974 with the full faith and credit of the United States, it was not until 1979 that the corporation entered the private capital markets in its own name and without federal guarantee. Its securities are sold in what is referred to as the "government agency market" along with such entities as FNMA, Farm Credit Administration, Federal Home Loan Banks, and other government and quasi-government corporations. The security buying public had to be educated about the role and performance of Sallie Mae to induce purchase of its securities. This was particularly difficult because of the public perception of student loans in general. Sallie Mae has been successful in making the transition from the Federal Financing Bank to the private capital markets, but with the anticipated substantial increase in cost to the corporation. Sallie Mae's cost of funds has at times been greater than some of the financial intermediaries who are primary lenders in the Guaranteed Student Loan Program and, as a tax-paying institution, has been considerably higher than that of tax-free revenue bond issuers.

Given Sallie Mae's dependency on the private capital markets, prospective purchasers of our securities will be looking at a number of indices of corporate performance and health, including return on assets, as they look at a variety of investment choices.

2. You state you believe your debt-to-equity ratio to be higher than you would like--but are you not at much less risk in fact than other highly leveraged businesses because of the many federal guarantees and subsidies involved?

Sallie Mae's debt-to-equity ratio in early 1982, was approximately 72:1. As a general reference and for purposes of comparison, other quasi-government entities range to as high as

35:1, commercial bank holding companies to as high as 30:1, major commerical banks to as high as 20:1, and large consumer financial companies up to 8:1.

. The risk to Sallie Mae is not only the perception and reality that we are more highly leveraged than many other major financial institutions in the United States, but that this leverage multiplies impact of what may be perceived as minimal internal or external changes in the program or economy. Beyond the potential for principal loss, it must be recognized that in 1981, Sallie Mae earned 45 cents on each $100 of student loan assets held. Each system change, statutory or regulatory change, increase in postage, increase in servicing fees, or other change due to inflation that occurs after the asset has been acquired, erodes the yield on the existing asset base. In a highly leveraged environment such as Sallie Mae's, the impact of such change can be dramatic on the earnings and on the equity base and it is essential that the corporation be managed prudently to strengthen its equity base so as to continue to be able to attract capital in support of its social purpose.

3. You state your desire to bring your debt-to-equity ratio down. Do you envision accomplishing this by increasing stockholders' equity since, if anything, it appears your debt will rise substantially as you float more bond issues?

Since inception through mid-1982, Sallie Mae has earned $121 million of which $6 million has been paid in dividends, $56 million has been paid in federal income taxes, and approximately $59 million has been retained as equity and reinvested in programs of the corporation. Clearly, the corporation has retained a very significant portion of its after-tax earnings to augment its capital base. The return to stockholders of less than 5 percent of the earnings of the corporation in the first 9 years of its existence is considerably below the approximately 30 percent of earnings that most other financial institutions in aggregate pay back to their stockholders, and is accepted by Sallie Mae stockholders in supporting the corporation's long-term growth and commitment to service. Consistent with the experience of other quasi-government corporations, such as FNMA and Comsat, Sallie Mae will explore alternate means of strengthening and adding to its capital base, including the further issuance of common or preferred stock, convertible securities, or subordinated debt. It is our hope that over the next five years there will be continued progress through internally and externally generated capital funds to significantly reduce the corporation's debt-to-equity ratio.

4.a. If Congress were to make Sallie Mae a fully private actor in the marketplace, e.g., by enacting legislation empowering other financial institutions to do the same things that Sallie Mae does in all areas, and removing from her any power or status which could not be opened up in this way (except for the preservation of rights and duties concerning business originated under the current set-up), would this be detrimental to Sallie Mae's income or financial condition? Please be as complete as you can.

If the Congress decided to fully privatize Sallie Mae, regardless of the reason of such privatization, there are a number of immediate concerns. Assuming that issues of governance, corporate structure, and corporate purpose could be adequately defined prior to such a resolution, there would be a significant time period required to make the actual transition. Over a period of time the balance sheet would have to be further structured to look more like a private corporation's balance sheet, i.e., reduce debt-to-equity ratio, enhance capital base, enhance earnings, and the various attributes of a quasi-government corporation conferring agency status on our securities in the marketplace and which are in our legislation would have to be withdrawn gradually. The corporation has begun the process of privatizing itself in a number of ways--including the sale of its debt securities in the private capital markets; the possibility of expanding equity sales in the next few years; the management of its programs and the pricing of its services in accordance with the cost of its current and future funding; the implementation of a larger staff and the creation of a student loan servicing center--designed over a period of years to create a balance sheet and earnings trend, and an industry position that would be worthy of the support of security purchasers. Any attempt to shift from this gradual approach to an abrupt change of status could materially change investors' perception of Sallie Mae, resulting in significant and immediate increases in costs to the corporation. Given the very modest capital base relative to the size of the corporation, a possibility is that our securities could not get sold immediately, requiring a return to the Federal Financing Bank or other federal remedy.

4.b. What would be the effect of such increased competition on the federal student loan delivery system?

Congress created Sallie Mae to be a national secondary market providing credit in a variety of means to all eligible participants in student loan programs. During the past ten years, a number of institutions, including commercial banks and state agencies, have undertaken to emulate Sallie Mae's programs. By virtue of state law or regulation, choice of market, availability of funds, or availability of servicing infrastructure, many of these

institutions have been limited or have limited their participation in the student loan program. Indeed, some have participated and then dropped out, creating hardships for those unable to secure student credit. Sallie Mae has consistently offered its programs on a nationwide basis and plans to continue to do so. To the extent that increased competition provides choice and the availability of capital to a larger number of students and parents, Sallie Mae welcomes competition. The risk to the program is that increased competition in the short-term might weaken the corporation so that in the long-term it could be difficult for Sallie Mae to satisfy all appropriate credit demands, when it may be the only national participant in the marketplace.

5.a. You state it is necessary to maintain a healthy growth in stockholders' equity and in dividends in order to inspire enough confidence in investors to attract them to your obligations in the private capital market. However, is it not true that the type of sophisticated investors who move in that market will scrutinize the financial condition and operation of Sallie Mae beyond these two measures?

Participants in the institutional fixed-income markets where Sallie Mae operates scrutinize every aspect of our financial condition, starting with our equity account, which is commonly referred to as "the cushion," to absorb unexpected business reversals. Our earning streams and every conceivable aspect of our financial operation are reviewed by analysts of major institutions prior to investment in our program.

5.b. For example, even if Sallie Mae paid no dividends but rather plowed all of its net income back into additional student loans, would this matter to prospective Sallie Mae bond purchasers, and if so, in what way?

Sallie Mae has a large number of shareholders who invested capital in the corporation with expectation of reasonable reward, both current and long-term. Our shareholders have recognized the need to build our capital base through retained earnings and have accepted a less than usual current return in the form of dividends. Ultimately, a larger share of the earnings may have to be distributed to shareholders, particularly if the corporation wishes to broaden its capital base through the sale of additional shares to a larger potential group of purchasers. Bondholders generally would be more interested in the general economic and financial well-being of the corporation and the adequacy of capital accounts.

5.c. Does the issuance of stock at this point represent a significant source of funds for Sallie Mae?

The issuance of stock could represent a significant source of additional funds for Sallie Mae, adding to our equity account, reducing our leverage ratio, and providing funds for acquisition of student loan assets.

Sallie Mae has considered the possibility of selling additional shares during the past few years, but the equity markets in general, the markets for share in financial institutions particularly, and the below book value market for Sallie Mae shares, have been inhibitants to such an offering.

5.d. Further, would it make any real difference to prospective bond purchasers whether Sallie Mae accumulated additional shareholders' equity or simply maintained its current figure by voluntarily using accrued earnings in other areas? In other words, is not the fundamental health of such an organization as yours and the status of its accounts for bond servicing more important to bond investors than the particular use to which the corporation puts its profits?

Sallie Mae's inceptional capital, retained earnings, and borrowings, are all invested in student loan program assets.

Earnings retained by the corporation strengthen the corporate balance sheet, improve the debt-to-equity ratio, and are invested in student loans. Prospective bondholders quite rightly reflect on the strength of the balance sheet of a corporation, are generally more willing to invest with a better balance sheet, and will accept a lesser yield on the securities of a corporation with a stronger balance sheet.

6.a. Under Sallie Mae's current authority and practice in consolidating GSL, HEAL and NDSL loans, does the federal government's responsibility to pay the GSL special allowance expand to include special allowance payments on the entire new consolidated GSL/HEAL/NDSL balance?

The federal government is obligated to pay a special allowance for consolidated loans consisting of GSL and NDSL notes. HEAL loans are not currently being consolidated nor would consolidated HEAL loans be eligible for special allowance payments.

6.b. Does Sallie Mae have amendments to propose addressing this problem of increased federal exposure where none was originally intended?

Sallie Mae has agreed with the Department of Health and Human Services and the Congress that the intent of the original loan consolidation language was not to permit interest subsidization of HEAL loans, and agreed prior to legislative remedies not to consolidate HEAL loans in such a way as to provide an interest subsidy to HEAL borrowers. Proposed language has been agreed upon and is awaiting introduction.

7. Mr. Fox, could you please explain the role Sallie Mae has taken in the Health Education Assistance Loan Program or the HEAL Program as it is more commonly referred to?

Sallie Mae has participated in the HEAL Program in a two-fold manner. First, since the inception of the HEAL Program in 1978, Sallie Mae has acted as a secondary market for purchasing HEAL loans from participating lenders. To date, Sallie Mae has purchased $31 million under the regular loan purchase program. Sallie Mae also recently signed a forward purchase commitment with Chase Manhattan Bank for $80 million. These purchase transactions reflect 87 percent of total HEAL originations. Second, with approval by the Department of Health and Human Services, Sallie Mae recently developed the HEAL Assured Access Program to assure HEAL loan availability nationwide. Under this Program, Sallie Mae will process HEAL applications and service the loans. The loans will be issued through the First American Bank of Washington, D.C., with immediate purchase by Sallie Mae. Program operations commenced in July, 1982. This Program was developed in response to Chase Manhattan Bank's decision, announced in May, 1982, to limit HEAL lending to prior borrowers or borrowers in six states.

8. What is the average amount of these loans?

The average HEAL loan size is $7,210.

9. Are they expensive to process? More so than NDSL or GSLP? What is the reason for the difference?

HEAL loan application processing is similar to that of the GSL Program. Costs per note are comparable. Current servicing costs are similar to GSLP loans but, because of the longer term to maturity (up to 25 years), future servicing costs are unknown and, depending on inflation, could be far more costly.

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10. Can Sallie Mae make these loans directly?

By law, Sallie Mae cannot be a direct HEAL lender.

11. Have banks been willing to make HEAL loans in the past? Would this picture improve if Sallie Mae were to become an originator of HEAL loans?

To date there are 45 active HEAL lenders with seven institutions originating approximately 99 percent of the HEAL volume. Chase Manhattan Bank is by far the largest lender with 81 percent of the volume in FY 1981. As a lender-of-last-resort, Sallie Mae would assure access to all qualifying students under the Program.

12. If Sallie Mae were to become an originator of HEAL loans, would this discourage banks from remaining with the Program?

The HEAL Program office indicates that one new bank and possibly several more are interested in participating as HEAL lenders for the first time. It is not likely that Sallie Mae's HEAL Assured Access Program would discourage other lenders. Banks can use the HEAL Program to develop future clientele and have access to Sallie Mae's secondary market.

13. If Sallie Mae were to become the only institution willing to deal in HEAL loans, would the September 30 expiration of Sallie Mae's "one year bankruptcy provision" signal the end of the HEAL Program?

If Sallie Mae were unable to finance itself, both HEAL and GSLP originations would certainly diminish substantially. Institutions and students have come to depend upon the corporation for a very significant share of capital to support student credit.

14. If Sallie Mae were to become an originator of HEAL loans, what advantage, if any, would this provide to students, the federal government, and/or Sallie Mae?

Under the HEAL Assured Access Program, Sallie Mae utilizes one central processing facility, guarantees timely processing of applications and disbursement of loan proceeds, utilizes sophisticated computerized loan servicing operations, provides training for financial aid officers from participating schools, provides a comprehensive program manual for aid officers, and has developed a debt management guideline for students. Sallie Mae also has developed close working relations with HEAL Program staff.

15. In the 1981 Reconciliation Act, Sallie Mae was given the authority to consolidate HEAL loans with other student assistance loans. Is this being done by Sallie Mae, and is there an advantage to either student or the government when such loans are consolidated?

Because HEAL loans are unsubsidized and have a variable interest rate tied to the 91-day Treasury bill, reconsideration of Sallie Mae's authority to consolidate HEAL with GSL loans has been undertaken by both the Department of Education and the Department of Health and Human Services. It has been decided by the Departments to prohibit the consolidation of unsubsidized with subsidized loans. In conjunction with this decision, the Departments approved the consolidation of Nurse Training Loans and Health Professions Student Loans with GSL and NDSL loans under Sallie Mae's OPTIONS Program. To this end, Sallie Mae is working with the Congress and the Departments to amend this authority to reflect these two decisions.

16. Current law requires that HEAL borrowers must pay a minimum annual amount that is not less than the annual interest due on the outstanding principal of the student's aggregate HEAL loan. This means that as students begin their careers they must immediately begin payment on their HEAL loan.

Has the immediate payback provision been difficult for students to meet? Has it affected the average default rate of HEAL loans?

Under HEAL statute, HEAL borrowers have a ten-month grace period after either ceasing full-time study or completing a residency or internship. This allows students time to establish a practice or pursue their professional objectives. Thus far, HEAL defaults have been low; however, few of the outstanding HEAL loans are currently in repayment. It is not possible to say that the annual interest repayment requirement is the cause of existing defaults. Many other factors may come into play.

17. Would banks be more willing to provide capital for HEAL loans if the HEAL lender were provided a more relaxed graduated repayment schedule?

Current law requires that HEAL lenders provide a graduated repayment schedule to borrowers. By law, borrowers have between 10 and 25 years to repay their HEAL loans. A more relaxed graduated repayment schedule will not necessarily be the deciding factor for a lender to provide more capital. However, such a relaxed schedule could be less burdensome and more manageable for the borrower.

QUESTIONS FROM SENATOR RANDOLPH

1. What percentage and dollar amount of GSLs which are currently in repayment have you purchased through your "loan sale" program?

As of July 31, 1982, $1.238 billion of loans in repayment were owned by Sallie Mae. As the Department of Education is not able to provide Sallie Mae with an estimate of outstanding GSLs in repayment, we cannot compute our share.

a. What is the average portfolio size purchased?

The median sized portfolio purchased by Sallie Mae is about $350,000.

b. When are GSLs purchased at par (face value), below par, above par?

Sallie Mae's par purchases comprise 98 percent of total transactions. If the portfolio offered for sale does not qualify for a par purchase, the seller may either accept a discount price or remove low balance loans from the offered portfolio in order to complete a par transaction. Sallie Mae also offers a special Community Lender Program which allows first time lenders in underserved areas to sell a substandard portfolio at a par price rather than at a discount price. Sallie Mae may also be able to offer the customer a warehousing advance loan to help create liquidity for GSL lending. Sallie Mae does not purchase paper above par.

c. Under what circumstances would you not purchase GSLs?

Loan origination deficiencies such as incomplete or erroneous documentation are the primary reasons that Sallie Mae would not purchase GSLs. These deficiencies usually result in non-compliance with program regulations. It is Sallie Mae's intent to minimize the risk of invalid loan guarantees resulting in rejected default claims. Sallie Mae documentation requirements are the same as those of the state guarantors and the Department of Education.

Sallie Mae does not normally purchase repayment paper due to the operational difficulties involved with the transfer of the paper to a Sallie Mae servicer and redisclosure of repayment terms.

2. What percentage and dollar amount of the outstanding GSLs held by program lenders have been used as collateral for loans to make additional GSLs under your "warehouse advance" program?

Sallie Mae currently has $2.8 billion in outstanding advances. GSL lenders have pledged $3.4 billion in collateral for these advances, which is approximately 18 percent of the outstanding GSLP.

a. What is the average loan size?

The average advance outstanding approximates $11.0 million. However, six advances constitute 32 percent of outstandings. The average advance declines to $7.6 million if these six advances are not considered.

b. How is the interest rate determined?

Sallie Mae's warehousing advances (loans) to financial and educational institutions are generally priced at interest rates with a fixed spread to the 90-day T-bill. Since Sallie Mae negotiates the majority of its borrowings also at rates which tend to move with the T-bill, warehousing margins are set to net Sallie Mae its required return.

c. Under what circumstances would you not provide a warehouse advance?

There are four circumstances where Sallie Mae would not provide an advance: the borrowing institution does not have sufficient collateral; the collateral quality is poor, consisting of loans which were not originated or serviced in accordance with GSLP regulations; the borrowing institution's financial position is poor, and the ability to repay is questionable; and the borrower cannot meet the student loan re-investment provisions in the law.

3. The net income (profit) on Sallie Mae's operations increased by 91.2 percent between 1980 ($9.4 million) and 1981 ($18.1 million).

a. Can we assume from your balance sheet that providing a secondary market for GSLs is a profitable activity?

The return on assets for Sallie Mae was .45 percent in 1980 and .45 percent in 1981. Banks in the aggregate had a significantly higher return on assets during the same period while providing traditional banking services including commercial and consumer loans.

b. Do you think that because GSLs are insured against default by the federal government, the federal interest subsidy might actually overcompensate lenders in comparison to other non-federally insured loans?

There is no evidence that the rate of return on a student loan is of above average yield to a lender when compared to alternative investments. The gross yield to lenders during the past few years has frequently been less than the prime interest rate even before consideration of high origination costs and servicing fees.

c. What was your profit rate for 1980 and 1981?

Sallie Mae's rate of return on assets for 1980 and 1981 was .45 percent, or 45 cents on each $100 invested.

4. The New England Education Loan Marketing Authority (Nellie Mae) was recently established by the state of Massachusetts for the purpose of creating a secondary loan market in New England for GSL lenders which cannot meet your minimum portfolio size requirements.

a. Do you see Nellie Mae as providing competitive or complementary services to your operations?

b. How do you plan to modify your marketing operations in New England in view of the establishment of Nellie Mae?

To date, Sallie Mae has provided over $350 million in financing to Massachusetts lenders. We plan to keep our secondary market available to all our existing clients as well as any other lenders who choose to use our services.

It is a point of some pride that Nellie Mae's operations are modeled after our own, including the use of the Massachusetts Higher Education Assistance Corporation (MHEAC) as the loan servicing agent. MHEAC's servicing operations were established in October, 1980, following extensive consultation with Sallie Mae's operational staff. Sallie Mae's loan servicing standards, adopted by MHEAC, are generally recognized as the most comprehensive in the business.

While we do not have a minimum portfolio size, some lenders may have difficulty in meeting other Sallie Mae loan sale requirements. For example, our statute states that commercial banks with deposits of $75 million or more may not require an account relationship of students as a prerequisite to receiving a student loan. We, therefore, view Nellie Mae's activities as complementary to our own--to assist lenders who cannot or do not care to meet our requirements.

5. The Omnibus Budget Reconciliation Act of 1981 authorized Sallie Mae to provide consolidated and extended repayment terms of GSL borrowers. Since the legislation provides

that only your organization will be permitted to offer this service, what steps have you taken to ensure that these services will be available to the widest potential market? 1/

1/ The Reconciliation Act authorized Sallie Mae, or its agent, to act as a direct lender to make consolidated or extended repayment insured loans to borrowers who have insured loans from more than one lender in excess of $7,500 or from one lender in excess of $5,000. The Act provided that Sallie Mae may designate a State student loan guarantee agency as its agent under this part.

In implementing its loan consolidation service, Sallie Mae has coordinated several nationwide communication efforts designed to reach the entire program marketplace. These efforts include: a series of direct mailings to potential borrowers; providing schools and banks with information packages to mail to loan consolidation candidates; providing information to numerous media representatives; providing releases to the National Association of College and University Business Officers (NACUBO) and the National Association of Financial Aid Administrators (NASFAA), who in turn have communicated with over 2600 schools; and attendance by Sallie Mae representatives at NACUBO/NASFAA workshops and reaching in excess of 1000 school student loan administrators through presentations at these conferences.

a. What do you anticipate the market will be for this service and what rate of profit do you expect to earn?

The market for loan consolidation appears to consist of recent graduates who are either in grace or who have entered repayment within the past two years. While older borrowers are eligible, our experience through direct mail and surveys indicate that they are generally not interested in the program. It would appear that the market is much smaller than originally thought--probably in the one to $300 million range rather than in the billion dollar range.

Due to start-up systems and other operational costs, Sallie Mae will probably suffer negative cash flow on this product in the first two years, but we hope to raise the yield to about .7 percent eventually. This profit, however, is entirely contingent upon our ability to borrow long-term funds in the private sector capital markets at favorable interest rates and to control operating costs.

b. How many loans have been consolidated and what is their total cumulative value?

As of August 31, 1982, over 5,900 loans totalling $38.2 million have been consolidated.

c. Are these considered loans more profitable than other GSLs?

A consolidated loan, if anything, is less profitable than an equivalent sized GSLP loan due to the longer terms for repayment which add inflationary servicing costs. Hopefully, over time the consolidated note will generate a profit equal to Sallie Mae's existing GSL portfolio. However, this profit margin is entirely contingent upon Sallie Mae's ability to obtain private capital at favorable rates for the next 20 years and to control servicing costs.

d. If these loans are more profitable, could you list some reasons why you should continue to have exclusive rights to offer this service?

Several reasons indicate that a single originator would prove to be in the interests of both the market and the federal government.

A single originator provides a standardized process and automatically increases the efficiency of overall program monitoring. Program enhancements can be implemented more quickly with one originator. Creditors are less affected than by having several sets of rules to follow and will, therefore, be more timely and accurate in reporting the required information. Economies of scale can be gained so that the product can be offered to the applicant in a more timely, efficient, and less confusing manner. Fully taxable private capital is used for sourcing the funds to be loaned which frees up funds at the federal and state level to be used for current and new borrowers. Loan consolidation data base information is centralized and, therefore, more readily accessible. Since no single state has a majority of the volume of the GSL, state-by-state activity would be more costly to administer than a single program. A single originator with one set of procedures enables earlier, easier planning for the enrolling student and guidance provided by the various financial aid administrators and bursars is facilitated by one set of procedures.

e. Continuing with the previous question, if these loans are indeed more profitable, won't the loss of these loans by state direct loan agencies have a potentially negative effect on their ability to break even, let alone show a profit?

As previously stated, there is no evidence that these loans will be more profitable.

To date only 5 percent of the underlying loans consolidated have come from direct lenders. The largest number of loans from one direct lender is 62 (this lender has actively requested Sallie Mae to mail to its borrowers). It should be noted that more than half of the direct loans paid off so far have carried balances under $5,000. Since earnings are based primarily on loan size and repayment terms, these loans represent the low side of the balance range and, therefore, the low side of the profit range.

6. The Ominibus Budget Reconciliation Act of 1981 authorized you to provide a program of national loan insurance and act as a secondary market for uninsured student loans. Do you anticipate providing this insurance for loans which could be made under the newly enacted state student loan programs in Maryland, Massachusetts, and Illinois?

Sallie Mae does not anticipate providing insurance under the authorities of the Ominibus Budget Reconciliation Act of 1981.

a. How do you plan to set insurance rates under this program?

Not applicable.

7. The Omnibus Budget Reconciliation Act of 1981 also authorized Sallie Mae to undertake any other activity which you determine would expand access to either insured or uninsured loans or that otherwise supports the credit needs of students.

a. Could you interpret this to mean that you could compete directly with state guarantee agencies in providing GSL loan insurance?

The Omnibus Budget Reconciliation Act of 1981 (the Act) empowered the Board of Directors of Sallie Mae to authorize the corporation to undertake additional programs in support of postsecondary credit. The purpose of this provision is to allow Sallie Mae flexibility in offering financial support for student loans which is responsive to a constantly changing economic environment and meets the evolving needs of the postsecondary educational community and the financial sector. The Act does not authorize Sallie Mae independently to provide a program of GSL loan insurance nor does Sallie Mae have independent authority under the Higher Education Act of 1965, as amended, to offer a program of loan insurance which

would be competitive with state guarantee agencies. Sallie Mae's ability to act as guarantor is narrowly drawn to provide that the corporation may act as a guarantor pursuant to agreements with the Secretary of Education with respect to consolidated loans. The corporation has no plans to act as a guarantor of consolidated loans and currently has an agreement with the Secretary whereby the Department of Education acts as the guarantor. The Act further provides that the Secretary may enter into an agreement with Sallie Mae to act as a guarantor with respect to GSLP loans other than consolidated loans only if borrowers are seeking loans and no state agency or nonprofit insurer is capable or willing to provide a loan insurance program. The corporation does not anticipate such an eventuality to occur.

b. Could you interpret this to mean that you could offer your own student loan program?

Sallie Mae is authorized to provide financial support for programs of uninsured loans. At present, no significant demand for additional credit has been noted by the postsecondary educational community. However, if it appears that current programs of student loans are not sufficient to meet the needs of students or their families, Sallie Mae would seriously consider working with the educational and financial sectors to identify the source of such demand and to develop limited programs which would encourage the financial sector to be responsive to the need for additional credit over and above the insured loan program.

8. Sallie Mae recently reached an agreement with the Secretary of the Treasury to cease borrowing funds through the Federal Financing Bank (FFB) on September 30, 1982, or when Sallie Mae's total borrowing reached $5 billion, whichever occurs first.

a. When will this $5 billion total be reached?

The final portion of the $5 billion was taken down on January 7, 1982.

b. What is the average interest rate paid on these loans?

All of the loans making up the $5 billion carry the same interest rate. Interest is calculated at the coupon issue yield equivalent (bond equivalent) of the auctions of the thirteen week (three-month) U.S. Treasury bills plus 1/8 of 1 percent. However, since interest is paid on a significant portion of the FFB debt weekly, the actual cost due to compounding was substantially higher.

c. Is this rate below the "prime rate"?

Yes, for example Sallie Mae's cost of debt from the FFB for 1981 was 14.76 percent, while the prime rate averaged about 18.8 percent for that year. However, "prime" is a proxy for income to a bank and was higher than the gross yield on guaranteed student loans. Costs of funds for banks in 1981 were generally lower than Sallie Mae's cost of funds.

d. How were the resulting interest savings applied to providing more efficient and lower cost services?

e. Could these services have been provided without the discount interest rates available to you via the FFB?

It is implied by question 8.c and d that without the FFB, Sallie Mae would have been borrowing at the prime rate. Sallie Mae's actual non-FFB borrowings have been significantly below the prime rate, both for its discount notes and its floating-rate notes. For example, for the month of July, 1982, Sallie Mae paid an average of 12.52 percent on its discount notes (bond equivalent basis) and 13.35 percent on its floating-rate notes, Sallie Mae's July total cost of non-FFB debt was 12.89 percent, while its FFB debt was only slightly lower at 12.49 percent. Meanwhile, the prime rate for the month averaged 16.26 percent.

Thus there was a cost savings to Sallie Mae by using the FFB, but much less than the spread between the FFB cost and the prime rate. Probably much more important to Sallie Mae than the relatively small cost savings, were the benefits of using the FFB from both the assured access to funds and a cost for those funds which was tied to the three-month T-bill. The guaranteed student loans have their earnings rate similarly determined by the T-bill auctions. This resulted in a stability of earnings to Sallie Mae and the ability to always borrow as needed to meet the demands for its services as the secondary market in student loans.

This stability as well as cost savings on funding were indeed passed on to its customers in terms of always standing ready to buy loans or warehouse them regardless of the gyrations of the interest rate cycle. Sallie Mae was also always there at a predictable and lower cost, allowing the original lender to have a positive earnings margin between the earnings rate on student loans and the cost to borrow funds from Sallie Mae under its warehousing advance program.

The ability to use the FFB when Sallie Mae was in its infancy may well have made the difference between a robust entity able to fulfill its secondary market mandate and a very

weak, uncertain corporation struggling to sell its debt. Sallie Mae's spectacular growth was due in a large part to its FFB funding.

Now that Sallie Mae has its nine years of strong financial operating history, it is finding the debt markets more open than would certainly have been the case had those years been low growth with weak or no profits. Nevertheless, the higher costs of funds and uncertainty of those costs outside the FFB have had to be reflected in somewhat higher rates charged on warehousing advances and a higher indebtedness required for a par purchase of student loans. Getting funds with a cost pegged to the T-bill rates, as the student loans earnings still are, is also more difficult.

f. When will these loans be repaid?

The first maturity is in October, 1986, and the last in January, 1997. As of August 1, 1982, the average maturity was 13.3 years.

g. How have these funds been applied towards the purchase and warehousing of GSLs?

All of the $5 billion is invested in guaranteed student loans or used for warehousing advances. The outstanding balances in those programs on August 1, 1982, were $5.8 billion.

9. Could you list the states to which Sallie Mae in 1981 provided "commitment to purchase agreements," to support student loan revenue bond issues by state student loan revenue agencies? 2/

2/ A "commitment to purchase agreement" provides that Sallie Mae, at the state's option, would agree to purchase the student loans made from the proceeds of revenue bonds at a set price for the purpose of redeeming the bonds at or prior to their maturity.

In 1981, Sallie Mae commitments supported about 32 percent of the student loan revenue bonds issued by state agencies which utilized a third-party purchase or financing commitment. The states to which Sallie Mae provided commitments to support 1981 student loan revenue bond issues or alternative funding arrangements are listed as follows:

	State	Agency	Commitment Amount
1.	WI	Wisconsin Higher Education Aid Board	$ 10.0 million
2.	CO	Colorado Student Obligation Bond Authority	$ 28.0 million
3.	WV	West Virginia Higher Education Loan Program	$ 15.0 million
4.	KY	Kentucky Higher Education Student Loan Corp	$130.0 million
5.	MI	Michigan Higher Education Student Loan Auth	$ 40.0 million
6.	VA	Virginia Education Loan Authority	$ 50.0 million
7.	OK	Oklahoma Student Loan Authority	$ 25.0 million

a. Under what circumstances would a state agency choose a lender other than Sallie Mae to provide such an agreement?

One reason a state secondary would elect to obtain a commitment from a source other than Sallie Mae is to avoid Sallie Mae's requirement that banks not require an account relationship as a prerequisite to receiving a student loan. Also, many banks are able to offer more attractive terms on a commitment as they expect to also realize profits on underwriting fees, servicing fees, general corporate banking services, etc. Another alternative to a Sallie Mae commitment is a letter of credit provided by a bank. A letter of credit ensures the agency's ability to retire all of its bonds, including those which are not supported by student loans (non-asset bonds), at maturity. Unlike banks, Sallie Mae is not currently authorized to issue letters of credit.

b. Under what circumstances would Sallie Mae choose not to provide a "commitment to purchase agreement"?

Sallie Mae commitments are available to all agencies which reflect satisfactory loan servicing and administration capability necessary to maintain the loan guarantee and loan origination or acquisition policies which do not conflict with the federal statutes which govern Sallie Mae's loan purchase requirements.

10. Sec. 439(a)(5) of the Higher Education Act authorizes the Secretary of the Treasury to purchase up to $1 billion of obligations issued by Sallie Mae.

a. Under what circumstances do you foresee the Secretary of the Treasury making such purchases?

As a practical matter, Sallie Mae views the $1 billion line of credit to the Treasury the same way that the Federal National Mortgage Association (FNMA) probably views its similar $2.25 billion line of credit. FNMA, even in its

current difficulties with massive losses and having to pay higher debt costs than the other government-sponsored agencies (SLMA, FHLB, Farm Credit Administration), has not chosen to borrow under its line.

The Sallie Mae $1 billion line is evidence to the credit markets of the government's commitment to student loans and of its support for Sallie Mae. The market takes comfort that this safety net is there should it be needed, similar to back-up lines of credit with commercial banks that most issuers of commercial paper have to reassure their lender.

To use the line would be admitting extreme weakness to the public debt markets and a sign that it is unable to borrow directly on its own credit. Therefore, Sallie Mae does not expect to ever draw on its line, and is attempting in every way possible to manage itself to that end.

11. The Ominibus Budget Reconciliation Act of 1981 authorizes Sallie Mae to be the lender of last resort if the Secretary of Education determines that no state or non-profit organization is willing or able to act in such capacity.

    a. In what states are you considering asking the Secretary for such permission?

Sallie Mae has not and does not expect to ask the Secretary for permission to be a lender of last resort in any state. We would anticipate that this authority would be exercised only upon a request from a state, with the approval of the Secretary, being forwarded to Sallie Mae.

12. Sec. 439(p)(1) of the Higher Education Act authorizes you to make advances or loans to state agencies for the purpose of making GSLs.

    a. Are you currently making any such loans?

No. Sallie Mae is unable to make such loans at this time because the Department of Education has taken the position that further legislation is necessary to clarify Sallie Mae's authority. The Department has indicated that it would support such legislative changes as part of a technical amendment.

    b. If yes, at what interest rate were such loans made?

Not Applicable

    c. Were you able to reduce the interest rate because of your access to credit from the Federal Financing Bank?

Not Applicable

13. Could you list any possible adverse effects to Sallie Mae if the bankruptcy provisions in the Older American Act of 1981 are allowed to expire at the end of this fiscal year? 3/

3/ Prior to the passage of the Older Americans Act of 1981, federal law provided that if Sallie Mae were to become insolvent but not proceed as a debtor under the Federal Bankruptcy Statute, then the federal government would have first priority access to any of Sallie Mae's assets. The Older Americans Act of 1981 (P.L. 97-115) amended this provision through September 30, 1982, by providing that the federal government would have equal priority to Sallie Mae's assets if Sallie Mae were to become insolvent but not proceed as a debtor under the Federal Bankruptcy Statute. In other words, the federal government would receive a prorated share of Sallie Mae's assets equal to all other creditors' shares, as opposed to previous law where the federal government would receive full payment prior to the payment of any other creditors.

Sallie Mae currently has a total of $2.5 billion of commitments, loans in progress, and short-term debt outstanding. As an ongoing corporation, Sallie Mae does not have liquid assets readily available to meet all of its current and contingent liabilities. The impact of the inability of Sallie Mae to access the securities markets would mean the inability of the corporation to meet its contractual obligations.

a. How would it affect your bond ratings?

The corporation is currently held in high esteem by its bondholders and, as a quasi-government institution, is not rated by rating agencies. Any adverse actions or weakening of the corporation would inhibit or reduce its ability to sell bonds.

b. What proportion of Sallie Mae's debt is currently held by the Federal Government?

As of July 31, 1982, the FFB, a profit-making agency of the federal government, holds $5 billion of intermediate and long-term debt of Sallie Mae. Other liabilities total $1.2 billion.

QUESTIONS FROM SENATOR STAFFORD

1. What would you describe as Sallie Mae's role? Does Sallie Mae have a direct or indirect responsibility to students? Does such a responsibility conflict in any way with Sallie Mae's obligations to its shareholders or bond-holders?

As stated in Sallie Mae's enabling legislation, Congress' purpose in establishing Sallie Mae was "... to establish a private corporation which will be financed by private capital and which will serve as a secondary market and warehousing facility for student loans ... and which will provide liquidity for student loan investments ..." Although Sallie Mae's direct activities have been, and continue to be, primarily in support of lenders under the Guaranteed Student Loan Program (GSLP), Sallie Mae's ultimate objective has always been to increase the availability of credit to the student borrower. It has achieved this objective by providing liquidity to lenders already engaged in lending under the GSLP, thereby enabling them to continue and to increase their lending activity, and by encouraging new and inactive lenders to enter the GSLP, thereby expanding the sources of credit available to student borrowers. Although the Education Amendments Act of 1980 did expand Sallie Mae's ability to provide direct assistance to student borrowers, primarily through the consolidation of their previously existing loans, the corporation's future activities will continue to be devoted primarily to assisting lenders through the provision of secondary market services.

As contemplated in the legislation establishing Sallie Mae, it was intended that the corporation finance its activities through private capital contributed by bondholders and shareholders of the corporation. Sallie Mae undertook an offering of common stock in 1974 and now has approximately 1,000 shareholders. In common with other private, for-profit corporations, Sallie Mae has fiduciary responsibility to its shareholders and bondholders to conduct its activities in an efficient, businesslike manner and to pay a return on the investment of these investors. On the other hand, Sallie Mae recognized its public responsibilities under the GSLP and the role it was intended to fill. Accordingly, it is ever cognizant of the need to balance the interests of its shareholders against the needs of student borrowers. Sallie Mae has never had any difficulty in balancing these interests and needs nor does it ever expect that it will. To date, Sallie Mae has fulfilled the needs of lenders under the GSLP, thereby satisfying its responsibilities to student borrowers. At the same time, it has been able to pay a modest rate of return on the investment of its shareholders.

2. Sallie Mae's profits increased by 91 percent from 1980 to 1981, and by an additional 40 percent in the second quarter of 1982.

a. Can we assume from this that providing a secondary market for GSLs is a profitable activity?

The return on assets for Sallie Mae was .45 percent in 1980 and .45 percent in 1981. Banks in the aggregate had a significantly higher return on assets during the same period while providing traditional banking services including commercial and consumer loans.

b. To what do you attribute your profitability?

Profitability is a function of careful pricing of services creating gross income from which are subtracted servicing costs, general administrative expenses, and income taxes, to arrive at earnings. The corporation has worked hard to develop servicing standards that are consistent and supportive of state and federal law and regulation, which is a costly process. Servicing efficiencies and improvements in general and administrative costs through economies of scale have enabled the corporation to partially offset higher financing changes reducing the need to materially increase the price of services in 1982.

c. What is your debt-to-equity ratio, and do you feel that Sallie Mae is too highly leveraged?

As of July 31, 1982, our debt-to-equity ratio was 71:1. Because the corporation has attempted to match the maturity structure of its assets with the maturity structure of its liabilities, it does not have many of the "gap" problems that many financial institutions (savings & loans in particular) have exhibited in the past few years. We would be more comfortable with a lower debt-to-equity ratio because 71:1 is higher than all other financial institutions and is inceptionally disconcerting to prospective buyers of our securities. By maintaining a modest dividend, we hope to build our capital through retained earnings and thereby lower our debt-to-equity ratio.

d. Since GSLs are insured by the federal government, do you think the federal interest subsidy adequately compensates lenders in comparison with their returns on non-insured loans?

There is no evidence that the rate of return on a student loan is of above average yield to a lender when compared to alternative investments. The yield to lenders

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during the past few years has frequently been less than the prime interest rate before consideration of high origination costs and servicing fees. Federal interest payments subsidize the student, not the lender, and bring the yield on a guaranteed student loan to an adequate but not exceptional level. The yield on a student loan is lower than other less administratively costly consumer programs managed by financial institutions.

e. What do you do with your profits? Would you describe Sallie Mae's compensation program, and any deferred savings or bonus plans?

For the nine years that Sallie Mae has been in existence through June 30, 1982, the corporation has earned $121 million. Of that amount, it has paid $56 million in federal income taxes and $6 million in dividends, creating retained earnings of $59 million, all of which has been reinvested in programs of the corporation.

In 1975, the corporation retained Hay Associates, a nationwide consultant in compensation and benefits to help the Board of Directors construct a salary policy for all positions and which would enable the corporation to recruit highest quality personnel on a fair and competitive basis. Using the Hay system, job descriptions for each position were rated and salary ranges were created. For clerical, technical, and professional staff positions, Sallie Mae's compensation practice is consistent with other organizations, including the federal government, in the Washington, D.C., area. Senior level positions and officers are generally compensated at lower levels than their industrial or financial counterparts with equivalent positions. Sallie Mae employees are provided with health and life insurance, a pension plan, and educational assistance benefits. No employees receive deferred compensation. All employees are eligible for a Thrift & Savings Plan after one year of service which vests over a five-year period. Contributions of up to six percent of salary are matched on a two for one basis by the corporation. While bonuses have not been paid to date, bonuses will be paid to key employees in 1983 as the corporation moves to a pay for performance strategy consistent with most other American corporations.

f. Has your profitability helped to increase access to capital for student loans?

Sallie Mae's strong balance sheet and record of profitability have enabled the corporation to tap capital markets in support of student credit. While the cost of this capital has been greater than that available from the FFB, our

success to date has enabled the corporation to make credit available in support of the Guaranteed Student Loan Program without materially raising its prices. Through September 30, 1982, the corporation has made more than $8 billion available in support of the Guaranteed Student Loan Program.

3. What percentage and dollar amount of GSLs have you purchased through your loan sale program?

Sallie Mae's current outstanding GSL portfolio approximates $2.6 billion, which represents 13 percent of the total GSLs outstanding. The first portfolio purchase was completed in the fourth quarter of 1974. Since that date, Sallie Mae has acquired approximately $3.2 billion through this program. Sallie Mae's participation in the Guaranteed Student Loan Program as a secondary market maker has consistently been greater relative to the amount of loans outstanding than the participation of all housing secondary markets combined.

a. What is the average portfolio size purchased?

The median sized portfolio purchased by Sallie Mae this year is about $350,000.

b. What is the minimum portfolio size? Do these sizes vary? Why?

Sallie Mae has no required minimum transaction size. Transaction sizes vary from less than $20,000 to as high as $30 million. The size is a function of the seller's total portfolio and the seller's preference. Sallie Mae does not differentiate its prices by portfolio sizes. This policy enables Sallie Mae to provide services to a greater number of clients with smaller portfolios.

c. When are GSLs purchased at par (face value), below par, above par?

Sallie Mae's par purchases comprise 98 percent of total transactions. If the portfolio offered for sale does not qualify for a par purchase, the seller may either accept a discount price or remove low balance loans from the offered portfolio in order to complete a par transaction. Sallie Mae also offers a special Community Lender Program which allows first time lenders in underserved areas to sell a substandard portfolio at a par price rather than at a discount price. Sallie Mae may also be able to offer the customer a warehousing advance loan to help create liquidity for GSL lending. Sallie Mae does not purchase paper above par.

d. Under what circumstances would you not purchase GSLs?

Loan origination deficiencies such as incomplete or erroneous documentation are the primary reasons that Sallie Mae would not purchase GSLs. These deficiencies usually result in non-compliance with program regulations. It is Sallie Mae's intent to minimize the risk of invalid loan guarantees resulting in rejected default claims. Sallie Mae documentation requirements are the same as those of the state guarantors and the Department of Education.

Sallie Mae does not normally purchase repayment paper due to the operational difficulties involved with the transfer of the paper to a Sallie Mae servicer and redisclosure of repayment terms.

e. Is your purchase price determined according to a formula, negotiation with a seller, or both? Do you have a standard portfolio pricing policy, like Fannie Mae?

Sallie Mae employs a standard discounted cash flow model in all investment decision-making analyses. The price generally offered for a portfolio of student loans is par, or 100 percent of the principal balance of the portfolio. A portfolio is determined to be of par value to the corporation if it exhibits cash flow characteristics that enable Sallie Mae to achieve a predetermined minimum return. The return is based on the portfolio characteristics as well as on our expectations regarding future servicing costs, and general administrative expenses. If the portfolio does not qualify for a par purchase, Sallie Mae will often negotiate with the seller to restructure the offered portfolio so that the characteristics meet Sallie Mae's requirements.

4. Last year, Sallie Mae reached an agreement with the Secretary of the Treasury to cease borrowing funds through the Federal Financing Bank (FFB) on September 30, 1982, or when Sallie Mae's total borrowing reached $5 billion, whichever came first. I am informed by your testimony that this total was reached earlier this year.

a. What is the average interest rate paid on these loans?

All of the loans making up the $5 billion carry the same interest rate. Interest is calculated at the coupon issue yield equivalent (bond equivalent) of the auctions of the thirteen week (three-month) U.S. Treasury bills plus 1/8 of 1 percent. However, since interest is paid on a significant portion of the FFB debt weekly, the actual cost due to compounding was substantially higher.

b. How much is this below the prime rate?

The average bond equivalent rate on the T-bill auctions held in calendar year 1981 was 14.75 percent while the prime rate averaged about 18.8 percent for that year. However, "prime" is a proxy for income to a bank and was higher than the gross yield on guaranteed student loans. Costs of funds for banks in 1981 were generally lower than Sallie Mae's cost of funds.

c. Have your resultant interest savings been applied to provide more efficient and lower cost services?

Sallie Mae benefitted by using the FFB from both the assured access to funds and a cost for those funds which was tied to the three-month T-bill. The guaranteed student loans have their earnings rate similarly determined by the T-bill auctions. This resulted in a stability of earnings to Sallie Mae and the ability to always borrow as needed to meet the demands for its services as the secondary market in student loans.

This stability as well as cost savings on funding were indeed passed on to its customers in terms of always standing ready to buy loans or warehouse them regardless of the gyrations of the interest rate cycle. Sallie Mae was also always there at predictable and lower costs, allowing the original lender to have a positive earnings margin between the earnings rate on student loans and the cost to borrow funds from Sallie Mae under its Warehousing Advance Program.

Before the FFB came into existence, Sallie Mae borrowed four times directly from the public. The first two times, in late 1973, the cost was .41 percent above the T-bill auction rates; but the last two times, in the Spring of 1974, the rate was .98 percent above the T-bill rates. A somewhat similar pattern of higher fluctuating debt costs has been the recent experience when Sallie Mae re-entered the debt markets in May, 1981. Also, access has been less certain as Sallie Mae had to postpone a planned borrowing in June, 1982, because of poor money market conditions.

The ability to use the FFB when Sallie Mae was in its infancy, may well have made the difference between a robust entity able to fulfill its secondary market mandate and a very weak, uncertain corporation struggling to sell its debt. Sallie Mae's spectacular growth was due in large part to its FFB funding.

Now that Sallie Mae has its nine years of strong financial operating history, it is finding the debt markets more open than would certainly have been the case had those years been low growth with weak or no profits. Nevertheless, the higher costs of funds and uncertainty of those costs outside the FFB are reflected in the rates charged on warehousing advances and the indebtedness required for a par purchase of student loans. Getting funds with a cost pegged to the T-bill rates, as the student loans earnings still are, is also more difficult.

d. Have these funds been applied towards the purchase and warehousing of GSLs?

All of the $5 billion is invested in guaranteed student loans or used for warehousing advances. The outstanding balances in those programs on August 1, 1982, were $5.8 billion.

e. How has this agreement benefitted the federal government or students generally?

The ability of Sallie Mae to act as a reliable and aggressive secondary market in student loans, made possible in part by its funding through the FFB, has benefitted students in making more loans available. Sallie Mae has substantial evidence that many lenders have entered, re-entered, or significantly increased their participation in the GSLP as a result of being able to sell their excess student loans to Sallie Mae for liquidity, usually to make more student loans, or because of the availability of warehousing advances at a rate both below its earnings rate on the pledged student loans and tied to the same index that also determines the student loan earnings rate, i.e., the three-month T-bill, thus, assuring a positive earnings margin on its student loans.

The federal government in fact has also benefitted. Sallie Mae pays to the FFB a small but significant spread above the FFB's cost of funds, totalling more than $20.0 million since inception. Sallie Mae also pays federal income taxes on its net earnings. Since inception through June 30, 1982, its payments have amounted to $55.7 million.

f. Is there any financial risk to Sallie Mae under this agreement?

Sallie Mae does not perceive any substantial risk at this time. Sallie Mae expects to have itself well positioned to be able to absorb the additional costs and uncertainty resulting from the maturities of the FFB debt from 1986-1997.

g. What impact do you expect this agreement will have on your profitability as you are required to enter more heavily in the public capital markets?

The corporation's profitability is a function of the revehues it earns on its student loans and warehousing advances less the cost of funding and administering those assets. To remain a strong viable secondary market, profitability is a necessity as well as a duty to Sallie Mae's stockholders. Because of the increased costs and uncertainties of the public capital markets, Sallie Mae already has found it necessary to raise its prices of warehousing advances and the average indebtedness for a par purchase of student loans. It is a very long-term question whether Sallie Mae will be able to maintain its former profit margins without unduly affecting the volume of business it does and, therefore, its effectiveness as a secondary market. It may well turn out that both profit margins and amount of activity will be lower than they would have been had Sallie Mae been able to continue using the FFB or using a full faith and credit guarantee in public capital markets.

h. What kind of return does Sallie Mae have to show in order to float bonds on the public capital markets?

Sallie Mae has been able to sell discount notes since May, 1981, and floating-rate notes in 1982 with a return on average assets of only .45 percent reported for calendar year 1981. However, the market made it known to us that since this key performance ratio had been declining over the last five years, it would much prefer a higher yield and an improving trend. Sallie Mae has worked hard toward this end and expects to report a significant improvement for 1982.

i. Will your entry into these markets be beneficial to the GSL program and students generally?

To the extent Sallie Mae is unable to absorb all of the increased costs and uncertainty of non-FFB funding through lower earnings margins, and must pass some of them on to its customers, its attractiveness as a secondary market will be diminished to some extent. Thus, the GSLP may suffer and students generally find loan availability lessened. Of course, Sallie Mae is making every effort to keep these effects to a minimum, but warehousing rates have already been raised slightly and par purchase average indebtedness requirement raised as a result of a higher cost of non-FFB debt.

Potential funding sources will be tapped to attempt to diversify sources and minimize costs.

5. Last year's reconciliation act authorized Sallie Mae to undertake any activity which Sallie Mae "determines to be in furtherance of the programs of insured students ... or will otherwise support the credit needs of students."

   a. How would you interpret this provision? Could you compete directly with state guarantee agencies in providing GSL loan insurance?

The statutory provision authorizing Sallie Mae to engage in activities which its Board of Directors "determines to be in furtherance of the programs of insured student loans ... or will otherwise support the credit needs of students" was designed to give Sallie Mae the flexibility to respond quickly to changing student credit needs. This type of provision is usually present in the charter of most corporations, including other federally chartered corporations.

Sallie Mae has not yet had the occasion to utilize this provision and I would not want to speculate on the types of activities it is intended to permit. I do think, however, that it is important to consider that this expansion of authorized activities does not exist in a vacuum. The authority is limited by its own terms to activities in furtherance of student credit. These activities must have the prior approval of Sallie Mae's Board of Directors. In addition, the activities would be subject to the oversight review of Congess and the Departments of Treasury and Education. Thus, while Sallie Mae now has the opportunity to be of assistance to the GSLP in a more flexible and timely fashion, it is subject to controls which will assure that its activities will continue to be concentrated primarily in the secondary market areas.

As to Sallie Mae's authority to compete directly with state agencies in granting GSL loan insurance, a separate provision in the Omnibus Budget Reconciliation Act specifically authorized Sallie Mae to establish a loan guarantee program in situations where eligible borrowers are seeking and unable to obtain loans, and no state or nonprofit private institution or organization is capable of or willing to provide a program of loan insurance. In such situations, the Secretary of Education could enter into an agreement with Sallie Mae to provide such a program. This provides the Secretary with the flexibility to request Sallie Mae to become a loan insurer in the event of some isolated shortfall in student credit either in a state where no state agency exists or if a state agency becomes unable to carry out its function. The Conferees stated their belief "that this standby authority is necessary to assure that loans are available to all eligible borrowers, regardless of

geographical location. Under no circumstances is this amendment to diminish the strengths and viability of new or existing state guarantee or nonprofit agencies."

Sallie Mae is well aware that its guarantee authority was intended as a "safety net" to be used only in extreme circumstances, and that the corporation has no unilateral authority under this provision. Any program of loan insurance must be carried out pursuant to an agreement with the Secretary. The Secretary has not requested such an agreement and none are anticipated in the near future.

6. Does Sallie Mae plan to be an originator of student loans, other than as a lender of last resort or a HEAL lender?

Sallie Mae has no plan to be an originator of student loans.

7. What has been your experience with the servicing of student loans, both your own experience in being a direct servicer, your relationship with state agencies, and with private servicing operations?

Sallie Mae has been in the business of servicing student loans since its first purchase in September, 1974, and has operated its own servicing center since August, 1980. Our servicing experience has been a favorable one, with consistent improvement over time. It is generally recognized that Sallie Mae's loan servicing standards are the most comprehensive of any in the business. The establishment of our own servicing center has provided us valuable insight into the process of servicing what is a most complicated debt instrument.

The maintenance of the positive relationship with the borrower, consistent with our obligations under federal and state laws and program regulations, has always been the focus of our servicing operations. Most state guarantee program directors have been cooperative and have recognized, to varying degrees, the potential for conflict between their own program requirements and our servicing operations in a high volume, multi-state environment. An increased measure of program commonality, however, would have a positive impact upon our operations, in terms of maintaining quality control and eliminating unnecessary administrative expenses.

8. What is your relationship with lenders in the state of Vermont and with the Vermont Student Assistance Corporation?

The Vermont Student Assistance Corporation (VSAC) has taken the position that Vermont enabling legislation does not allow VSAC to guarantee or pay default claims "to other than Vermont lenders." Therefore, although we have had many inquiries from loan originators in Vermont, we have not been able to provide our statutory programs in Vermont.

9. Would you please give us the distribution of asset size of the lenders with whom you deal?

Percent of Clients	Total Assets
50%	less than $100 million
30%	$101-500 million
5%	$500-1000 million
15%	over $1 billion

10. How would you view giving state guarantee agencies the authority to consolidate loans?

The loan consolidation program appears to be smaller than originally contemplated, quite complex to manage, and more costly than otherwise anticipated. Sallie Mae feels that a single consistent program financed with taxable dollars by a private sector corporation offers the best opportunity for a well-managed efficient service to students.

Senator STAFFORD. With that, we will turn to questions.

I will direct this to either one of you and, Senator Randolph, after about 5 minutes, I will yield to you and we can pass it back and forth as we need to.

Senator RANDOLPH. Fine.

Senator STAFFORD. Would you describe in a little more detail Sallie Mae's role; that is, does Sallie Mae have a direct or indirect responsibility to students? Does such a responsibility conflict in any way with Sallie Mae's obligations to its shareholders or bond holders?

Mr. FOX. We are not a part of the executive branch of Government. We are a private corporation and as such, with stockholders and bond holders, we have a fiduciary responsibility to those individuals. We sell our bonds and our stock in the private capital markets, consistent with the way other large corporations do.

The programs are administered by the various States and the Federal Government, and the appropriations in support of those programs come from here. We are not charged with subsidizing the guaranteed student loan program or subsidizing the students.

We feel it is our responsibility to attract private capital, consistent with prudent business management, in support of the programs that you have created. We feel a responsibility to do so in a way that supports the underlying role of those programs and to insure that a diligently managed, appropriately processed program is in place; that capital flows on a straightforward and consistent basis; and that the programs in their entireties meet the needs of the student borrowing population.

We are just one part of that. There is a large group of constituencies, including the government, the States, and the banking system which has provided most of the capital. We are a part of that; we try to work in concert with it. And we think that, consistent with business ethics and prudent business practice, we are supporting the needs of the students in that way.

Mr. MCCABE. I might add, Senator, if I may, to Mr. Fox's response that we believe that to the extent we operate ourselves as a sound, solid, financial institution, we better serve the underlying social purpose of credit for students; and we are very interested in that. But we get at it, I believe, by doing our assigned job as well as we possibly can.

Senator STAFFORD. Thank you.

Sallie Mae's profits increased by 91 percent, I am told, from 1980 to 1981, and by an additional 40 percent in the second quarter of 1982. Can we assume from this that providing a secondary market for GSL's is a profitable activity? And assuming it is, to what do you attribute your profitability?

Mr. FOX. Since inception, Senator, Sallie Mae has earned approximately $120 million. We are today a $6.5 billion corporation. Of that $120 million, we have paid $55 million in Federal income taxes. We have paid dividends to our shareholders of $5 million, and have taken the remainder, or approximately $60 million, into retained earnings which has gone into furtherance of Sallie Mae's programs. They have been reinvested in guaranteed student loans.

Those dollars add up, on an after-tax basis, to approximately one-half of a cent on each dollar that we have had invested. As I said

in my opening statement, if you were to compare that with the earnings of other financial institutions, we would be significantly on the low side.

If you were to look at the capital that this corporation has, it is about $85 million. That supports debt in excess of $6 billion. That is 70 units of debt for each unit of equity. As we go into the private capital markets to raise money in support of this corporation, people are going to be looking at our balance sheet and at our earnings before they are going to be willing to invest moneys in support of this corporation.

In actuality, our earnings are significantly lower and our leverage is significantly higher than those other institutions with whom we are competing in the marketplace for funds. If anything, the earnings of the corporation have been under what is probably reasonable in order to support continued access into the financial markets.

I do not think that they are particularly large. As a return on assets of 0.44 hundredths of a percent, as a matter of fact, they are quite low. If it is the intent of the Congress that there be a nonsubsidized institution that does not use any tax revenues in support of these programs—and the thrust has been in that direction during the last 5 years in terms of your legislation toward us—then we must have a sound balance sheet and adequate earnings in order to support access to the financial markets.

Senator STAFFORD. Regarding your debt-to-equity ratio, do you feel that Sallie Mae is too highly leveraged?

Mr. FOX. Currently, our debt-to-equity ratio is 70 to 1. That means that we are borrowing $70 for each $1 of equity that we have. We feel that we would like to bring that down over a period of time.

Our phenomenal growth in terms of assets, which have not been matched by growth of net worth, has exacerbated that debt-to-equity ratio over the last 2 or 3 years. We are trying to manage that now and trying to reduce it.

A debt-to-equity ratio is only risky if there is a mismatch in the sense that some of our savings institutions have had mismatches relative to the maturity of that debt, the maturity of the assets, and the cost of the debt relative to the earnings of the assets.

We have tried to manage the corporation prudently so that that 70 to 1 debt to equity ratio, which is higher than other quasi-Government entities and is higher than any other bank in the country, would not be perceived as prejudicial to the corporation in the marketplace.

Mr. MCCABE. Senator, if I may add, the marketplace consideration is enormously important because we are going out to the public marketplace to raise our funds, and we are, as Mr. Fox has indicated, nibbling away at this debt-to-equity ratio. It is higher than we would like to see it, but his explanation was a solid one for it.

Senator STAFFORD. Thank you.

Since the guaranteed student loans are insured by the Federal Government, do you think the Federal interest subsidy adequately compensates lenders in comparison with their returns on noninsured loans?

Mr. Fox. I had the benefit of chairing a committee for the Congress 4 years ago that reviewed the adequacy of the yield on the guaranteed student loan program. Certainly, with our own experience and our own published results, which were solely achieved from the student loan programs, we feel that we are in a good position to answer that question.

What we have found is that the guaranteed student loan program provides a modest return to institutions but is not as remunerative to a financial institution as other investments which they could undertake. We have seen many institutions getting into the guaranteed student loan program for reasons other than just pure credit to students. They do so because it is an adjunct to other forms of business, gives them the opportunity to provide service in their communities, and the like.

There is no evidence that we have seen, nor does our financial performance indicate that the yield on the guaranteed student loan creates an asset that yields more than institutions get in the normal course of business. As a matter of fact, earning less than one-half a percent on our investment on an after-tax basis, not including certain costs such as origination fees and the like, suggests that having run an efficient organization, this program is only moderately rewarding to those institutions that participate.

I think we owe a vote of thanks to the banking industry for having made available so many billions of dollars over the years in support of this program.

Senator STAFFORD. Thank you.

Senator Randolph, I have run a little over 5 minutes, so I will yield to you. I have got a couple of more questions.

Senator RANDOLPH. Go right ahead.

Senator STAFFORD. All right.

Last year, Sallie Mae reached an agreement with the Secretary of the Treasury to cease borrowing funds from the Federal Financing Bank on September 30 of 1982 or when Sallie Mae's total borrowings reached $5 billion, whichever came first.

I am informed through your testimony that this total was reached earlier this year, so my question is what is the average interest rate paid on loans, and how much is this below the prime rate?

Mr. Fox. Today, the agreement that we have with the Federal Financing Bank with the $5 billion is to pay them one-eighth of a percent above the 90-day Treasury bill auction, interest calculated weekly and paid weekly, which, on a compound basis, is significantly higher than just one-eighth of a percent on a more traditional basis.

We estimated that we are paying approximately one-third of a percent above the Treasury bill. In the past, we have paid considerably higher to them. Their fees have ranged from three-eighths of a percent to one-eighth of a percent over the Treasury bill in their charges to us.

We have calculated that at any given point in time that rate would be more attractive or less attractive than our costs of borrowing in the private capital markets. We have also estimated that the Federal income taxes that we have paid have more than offset the Government for any differentials that we might have received

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for having been in the Federal Financing Bank relative to outside costs of funds.

Today, because the Treasury bill is a very secure, preferred investment in a time of distrust of certain banking investments and the like, the cost of the Treasury bill relative to banking charges is much wider than it was as recently as 2 or 3 months ago. What that is going to do is to reduce the income of those institutions who are in the guaranteed student loan program, as well as reduce the costs to institutions like Sallie Mae relative to participating in that business.

Today, prime is at 15 percent. Today, the yield on the guaranteed student loan is about 13 percent or 13.5 percent. Our cost of funds from all sources is somewhere in the vicinity of 11 percent.

Senator STAFFORD. Do you consider your ability to profit from a large interest spread on these funds a Federal subsidy?

Mr. FOX. I do not view it as a Federal subsidy, Senator. The Federal Financing Bank is a profitmaking institution. It showed profits last year in excess of $100 million. I think the subsidies in the guaranteed student loan program are those dollars that are appropriated by the Congress to subsidize the student. I do not see any subsidies implicit in this program for the banking or lending institutions.

Senator STAFFORD. Now, to get to a parochial question, what is your relationship with lenders in the State of Vermont and with the Vermont Student Assistance Corporation?

Mr. FOX. We have relationships with 44 guarantee agencies throughout the country. We do not have a relationship at this time with the State of Vermont. It is our understanding that the representatives of the State guarantee agency have taken the position that Sallie Mae, not being an entity that is a lending institution that is located in Vermont and not being specifically granted the opportunity to be a holder of guaranteed student loans guaranteed by the State of Vermont is not permitted under statute to be a holder.

Therefore, there is no transfer agreement between the State and Sallie Mae which would enable us to own guaranteed loans guaranteed by the State. As I say, we do have such relationships with 44 other entities throughout the country.

As a result of that opinion that has been tendered to us by the head of the agency, and also by the apparent lack of willingness to get the legislation changed, we have provided something less than $250,000 of accommodation to the State of Vermont since we have been in business.

As a comparison, we have provided about $50 million in the State of New Hampshire, about $40 million in the State of Maine, and in excess of $350 million in the State of Massachusetts.

Senator STAFFORD. When you said 44 entities, are you referring to governmental units other than States, or are you referring to States?

Mr. FOX. There are approximately 55 entities, including State agencies, guarantee agencies, and those associated with Government territories, such as Guam and the Virgin Islands. We have agreements with 44 or 45 of those at this time and we do business at all of those institutions and States.

Senator STAFFORD. Thank you. I have several other questions, but I would like to submit them to you in writing for response at your earliest convenience in writing to the subcommittee.

Senator Randolph?

Senator RANDOLPH. Thank you, Mr. Chairman.

Mr. McCabe, this first question perhaps can lay a premise for others. Are all members of your Board users of Sallie Mae? If not, should they be?

Mr. MCCABE. All the members of the Board as I run it through my mind's eye here, Senator, are not users of Sallie Mae. I am a director of Sallie Mae, but my business is the private practice of law.

Senator RANDOLPH. Where do you practice?

Mr. MCCABE. Washington, D.C., Senator.

We have one director who is a newspaper publisher.

Senator RANDOLPH. Who is that?

Mr. MCCABE. A gentleman from Nashville, Tenn., named Irby Simpkins. I think it is the Nashville Banner; I hope he will forgive me if I misquote and use another paper on him.

Senator RANDOLPH. There is another newspaper there, of course.

Mr. MCCABE. Of course, a good number of the directors are affiliated with financial institutions and educational institutions which are lenders and, in turn, can have a relationship with Sallie Mae.

We have a gentleman on the Board who is an insurance official from the State of Rhode Island. I could run through these, but. . .

Senator RANDOLPH. We will make it certainly a part of the record.

Mr. MCCABE. I can submit the general background of each director for you, Senator, rather than run through all 21 now, if you prefer.

Senator RANDOLPH. Do you feel, as I have indicated, that they should be elected?

Mr. MCCABE. The elected directors should. . .

Senator RANDOLPH. Are they elected or appointed?

Mr. MCCABE [continuing]. Should have a relationship with Sallie Mae, businesswise. Is that your question, Senator? Maybe the reporter can read back the first part of your question. I thought you asked, should directors have a business relationship with Sallie Mae.

Senator RANDOLPH. I did, and then I asked should they be elected, rather than appointed, or both.

Mr. MCCABE. Well, it is both now; that is, elected directors are two-thirds of the Board. Appointed directors are the other one-third.

Generally, I would say, Senator, the system seems to work. There are a lot of ways you can structure a corporation, as you know yourself from your own corporate background. But I would not have any great feeling one way or the other of whether all directors should be elected or appointed. I think it is healthy for any corporation to have directors elected by shareholders. There is a discipline that goes with that—an oversight, if you will—from the shareholders who own the company.

But I really do not have any particular preference for one way of constituting the Board over another.

Mr. Fox. Senator, when the corporation was created, the Congress was using a format that had been used for many, many other corporations that were created prior to Sallie Mae. The various corporations in the housing area that make up the Federal Home Loan Banks, and the Farm Credit Administration agencies—maybe 37 banks around the country—are owned by the people who participate on a cooperative basis in those programs.

Certainly, the other two corporations which are privately held and which are listed on the New York Stock Exchange, which are models—Fannie Mae and Comsat—have boards of directors which are two-thirds made up of shareholders' representatives and one-third appointed in the public interest.

So, there is a consistency that was being followed when the corporation was being established.

Senator RANDOLPH. Mr. Chairman, and to the witnesses, I have an emergency call. May I take 30 seconds?

Senator STAFFORD. Certainly.

Senator RANDOLPH. Thank you, sir.

Senator STAFFORD. The Chair would like this to be in the record following Senator Randolph's questions, but the Chair has in hand a series of questions from Senator Orrin G. Hatch, who is the chairman of the full, parent committee of this subcommittee, which he would appreciate being answered in writing, gentlemen, if that is agreeable to you.

Mr. MCCABE. We would be glad to answer those, Senator.

Senator STAFFORD. Thank you.

While we are waiting for Senator Randolph, but again following his questions in the record, the Chair would ask this additional question. Last year's Reconciliation Act authorized Sallie Mae to undertake any activity which Sallie Mae "determines to be in furtherance of the programs of insured students, or will otherwise support the credit needs of students."

How would you gentlemen interpret this provision? Could you compete directly with State guarantee agencies in providing GSL loan insurance?

Mr. Fox. We are a creature of statute, Senator, and I think our authorities are very carefully prescribed and limited. In general, corporations that are created by the Congress in support of various programs have much broader overall authorities than Sallie Mae has.

For example, Comsat, which was created by the Congress, has an authority that reads that the board of directors can do anything which a board that is chartered under D.C. law can do.

If you were to look at the authorities granted to many, many other entities chartered by the Congress, you would find very broad, open-ended responsibilities given to the boards of directors, some of whom are elected and some of whom are appointed.

In our case, you prescribed very specifically that the Board may consider any responsibilities that are in support of student credit. That has directed us, and we feel obliged, to manage our corporation in support of the underlying GSLP and other modest programs in which we do business.

When you give somebody responsibility, you are also giving them accountability, and since our Board of Directors is a broad entity

that represents all of the constituencies that make up the guaranteed student loan program—lenders, borrowers, State agencies, and the like—I think what you have done is given the corporation the capacity to respond to specific needs when those needs make themselves apparent on a rapid basis in support of the guaranteed student loan program, but in a way that is consistent with all of the needs of all of the constituencies.

I do not believe that we have any open-ended franchise to go out and harm anybody. The corporation has always acted responsibly.

Senator STAFFORD. Thank you very much.

Let me ask you, does Sallie Mae plan to be an originator of students loans other than as a lender of last resort or a HEAL lender?

Mr. FOX. We have very, very narrow authority in which we can become an originator. We do not have legislation at this time that permits us to become an originator under the HEAL program; but, as a potential lender-of-last-resort, that may be forthcoming from other legislation.

In terms of our loan consolidation program, we can refinance existing outstanding indebtedness, which is a form of origination. There is no other way in which we can unilaterally become an originator without the support of either the Secretary of Education and/or the States where, on a geographic basis, there may not be the availability of credit.

We cannot and have not become an originator on a unilateral basis, and cannot do so under our legislation.

Senator STAFFORD. Thank you very much.

Senator Randolph, I asked a couple of questions in your absence. The floor is yours again, and, like you, I need to go out and make a phone call now.

Senator RANDOLPH. Thank you very much.

Mr. Fox, I want you and Mr. McCabe to know at the very beginning that we are not critics in any sense. But when matters of this type are called to our attention, we want to go into them thoroughly. I think you would agree with me that it is very important at this time to perhaps better understand the relationships of your quasi-governmental entity, in a sense, and your private operations through those that are affiliated and associated with you.

The first question that I want to ask at this moment of either of you who are at the table is, How many students loans, since Sallie Mae came into existence—I mean students involved; a loan to Mr. X or a loan to Ms. A—How many loans have been made?

Mr. FOX. By Sallie Mae?

Senator RANDOLPH. Yes.

Mr. FOX. We have entered into approximately 4,500 transactions with about 1,400 institutions in just about every State in the country. Those transactions have added up to about $7.5 billion.

Senator RANDOLPH. I caught that earlier. I am talking about the number of students that were actually benefited.

Mr. FOX. We can estimate in certain programs and we can be specific in others. In our purchase program, where we have purchased close to $3 billion worth of loans, we can estimate that that is approximately 1 million students.

In the Warehousing Advance Program, where we lend money to other institutions and they undertake the responsibility of lending

that money in support of student credit, we can estimate that a like number of students have benefited—another million students. Whether there is some duplication there, we cannot be sure.

Through our commitment programs, where we have extended commitments approaching $1.5 billion, we can estimate that those banks and State agencies who have received the benefits of those commitments from us have probably been able to make accommodations to students on a current, past or potential basis of between 300,000 to 500,000 students.

We would estimate that the moneys that we have made available have, in all probability, aided 2.5 million students in obtaining a postsecondary education.

Senator RANDOLPH. Over what period of years?

Mr. FOX. We began in 1973, last quarter.

Senator RANDOLPH. Then, you are saying that in approximately 9 years, if we say that as a rough figure, you have, through types of advance of moneys with which Sallie Mae is a part—2.5 million students have been benefited or have participated?

Mr. FOX. That is an estimate, sir.

Senator RANDOLPH. That is a very impressive figure; it certainly is.

Mr. Fox, I have noted that most of the association's printed materials state that Sallie Mae receives no Federal contributions. Yet, you have borrowed $5 billion from the Federal Financing Bank for use in the student loan activities conducted by Sallie Mae.

Now, I am asking you, Why is not that amount of money considered as Federal funds?

Mr. FOX. The $5 billion, sir?

Senator RANDOLPH. Yes.

Mr. FOX. The $5 billion has been borrowed from the Federal Financing Bank, which is a corporate instrumentality of the United States. It is not the U.S. Treasury Department; it is not appropriated funds. It is funds that that agency, administered by the Treasury, raises either from borrowings from the Treasury or in the private capital markets.

It is a different source of funds than a direct Treasury borrowing, which is something that we have never done. The $5 billion that we have borrowed, whether it came from the Federal Financing Bank or from the private capital markets, clearly could not have been raised in our early years if we did not have the full faith and credit of the United States behind us.

Creating a corporation from absolute zero 9 years ago, with no credit standing and no ability to borrow in its own name, obviously would not have been successful in obtaining capital. So, we realize that without that full faith and credit, we could not have gotten off the ground.

But, in all fairness, we do pay a rate of interest to the Federal Financing Bank that is above their cost of funds from whatever source they get it. Second on our earnings, we pay Federal income taxes which otherwise would not have been available to the Federal Government. And we have been able to calculate that the dollars that we have been able to give back to the Government have more than compensated for any differentials of cost that we might have gotten by virtue of using the Federal Financing Bank.

We had the opportunity of having appropriated funds to the corporation in 1973 for startup operating costs. We did not take those funds. We have never had any appropriated funds from the Federal Government.

Senator RANDOLPH. Well, it is taxpayer dollars, is it not?

Mr. FOX. No, sir.

Senator RANDOLPH. What?

Mr. FOX. No, sir.

Senator RANDOLPH. It is not from Treasury or taxpayer dollars?

Mr. FOX. No, sir.

Senator RANDOLPH. Where do the Federal Financing Bank dollars come from? You may have said, but let us say it again.

Mr. MCCABE. They raise at least a part in the private capital markets.

Mr. FOX. I would like to read some material specifically from the Treasury Department that I think would respond to that, Senator. This is from the Treasury Department's operations report of the past year:

> The Federal Financing Bank is a corporate instrumentality of the United States which is subject to the general supervision and direction of the Secretary of the Treasury. It is managed and operated by Treasury employees, who provide services to the FFB on a reimbursable basis. It was established by the Federal Financing Bank Act of 1973 to coordinate, reduce the costs and efficiently finance federal agency and federally-guaranteed obligations, and they are authorized to purchase obligations from a number of entities.

The Federal Financing Bank took the position in 1974 that Sallie Mae had to sell its obligations to the Federal Financing Bank. Prior to that, for the first 1½ years of our operation, we were borrowing in the direct capital markets.

Reading on, "The Act authorizes the FFB to issue its own debt obligations to the Secretary of the Treasury and to sell its debt to the general public." It goes on to say that it has a current lending rate, which means that it cannot only meet its costs but make a profit. And the statement goes on to say, "As of September 30, 1981, the institution had assets of $107 billion and had earnings in that year of $142 million."

I would be pleased to provide more definitive information relative to the Federal Financing Bank for the record. It is one of the least understood and one of the very largest financial institutions in the country, but it clearly has no appropriated funds, sir, nor does it come from taxpayer dollars.

Senator RANDOLPH. You made the statement—I did not—that it is least understood.

Mr. FOX. Yes, sir.

Senator RANDOLPH. So you can imagine why we are holding this hearing; is that not correct?

Mr. FOX. I sympathize with people who are not familiar with the arcane workings of that institution.

Senator RANDOLPH. We will place in the record the material appropriately of course, that is provided by the association—your corporate organizational structure and your corporate funding, which you have distributed or is available. That certainly would be agreeable to you, would it not?

Mr. FOX. Yes.

Senator RANDOLPH. Educational opportunity is the bottom line. That is your motto, in a sense. That is a good one, is it not?

Mr. MCCABE. It sure is.

Senator RANDOLPH. How about students as they go into college this September? What is the picture for students?

Mr. FOX. It is a little bit difficult, Senator. We follow this; and as recently as this morning I sat down with some of my staff persons because I expected to get that question.

The evidence that we have from the Department of Education and from the States is that in the first quarter of this fiscal year, the student loan program was moderately up. In the second quarter, it was significantly down, and we see that in the third quarter it is significantly down.

Our best estimate today for a variety of reasons, understanding that a very significant amount of lending will get done in this quarter, is that there may be as much as a 20-percent decline, or a $1.5 billion decline in originations in this fiscal year as compared to last fiscal year.

Translating that into dollars, where last year there might have been a $7.8 billion amount of originations, we would not be surprised to see that figure reduced to $6.25 billion this year.

It is very spotty. There are some parts of the country where programs are up; there are other parts where they are down very dramatically. There seems to be some misunderstanding amonq many parents as to just what the legislation of last year really did to them, and it appears that some persons who might otherwise qualify are not even seeking accommodation this year.

I think that the representatives of the various States who will be coming on after we do, and who are actually processing the applications, may be in a better position to give you more firsthand information. But it would appear that there is a significant reduction, not yet accurately determinable, in the amount of credit that will be extended to students for the coming school year.

Senator RANDOLPH. Mr. Fox, could you tell us precisely, not that you are in any way not being precise, what adverse effects would accrue to Sallie Mae if the bankruptcy provisions temporarily granted last year are allowed to expire on September 30?

Mr. FOX. Senator, the act which was passed last year with respect to which we are asking for a permanent extension, states that the Federal Government or its entities, as informed creditors, should be placed on an even keel with all other creditors of any entity were there to be some form of forced or voluntary liquidation.

For Sallie Mae, this is as important to be in place as it would be for any other prospective creditor who deals with the Government. What we are asking is nothing less than what any other institution dealing with the Government already has under the 1976 and 1978 bankruptcy amendments as approved by this Congress.

Were there to be a perception on the part of prospective buyers of our securities that, for whatever reason, they might not be able to get paid back for those investments which they make in our corporation for the purchase of our obligations, that would severely reduce their appetite or desire to want to purchase our obligations.

And we would have to pay a very, very high rate, if indeed we could get those obligations sold at all.

People are unwilling in these times to commit their dollars unless theie is an assurance that they are going to get paid back. To the extent that they are told there is a possibility that they may be a subordinated creditor to a very large creditor—the Federal Financing Bank—their willingness or their appetite to buy our securities in all likelihood will diminish, and the likelihood that we can finance ourselves or refinance our existing obligations is reduced very markedly and dramatically.

The possibility exists that we would have to hunker down, and indeed it would cause distress in the marketplace to those people to whom we have commitments. We have business in process; we have contractual commitments. We want very much to be able to honor those commitments to the various States, banks, and the like, and we would hope that would not come about so we would have to test our capacity to finance those commitments.

Senator RANDOLPH. What proportion of Sallie Mae's debt is currently held by the Federal Government?

Mr. FOX. The Federal Government, meaning the corporate instrument of the Federal Government—the Federal Financing Bank, has $5 billion and the general public today has approximately $1 billion. Those are the funds which we have raised during the past 9 months, following the completion of our borrowing at the limit set for us in our agreement with the Treasury last year.

Senator RANDOLPH. Mr. Fox, if Sallie Mae had permission or authority to lend directly to colleges, enabling those institutions to make uninsured loans through local banks, how much, in your estimation, would the Government be called on to pay for such a program, and who would set the terms for such loans? How high could interest rates go for students?

Mr. FOX. It is our opinion that the Guaranteed Student Loan program, as it is currently structured will be providing a very significant percentage of the accommodations necessary to support students going on to postsecondary education.

To the extent that the Congress disenfranchises, for cost reasons, some number of students who are forced to seek credit elsewhere, those students have only two options—either to find that credit from some other source, or else to forgo or change their educational plans.

We see no demand on the Corporation at the current time for loans to support uninsured accommodations to students. But we have had conversations with institutions, primarily the high-cost, limited-access institutions, who feel that in 1983 and 1984, many of the students that they draw upon for their institutions where tuitions have been rising markedly may find themselves without the means to attend their institutions. And they are starting to look for alternate sources of capital to provide loans to those students.

Some are doing it from their own funds in the form of loans from their endowments. Others are going to banks and finance institutions around the country looking for funds. Still others are either selling revenue bonds or contemplating the sale of revenue bonds in support of those kinds of lending programs.

To the extent that there is a banking system that will fill that vacuum, Sallie Mae will not be needed. To the extent that that vacuum is not totally filled and there are a number of students who have a bona fide and legitimate need for financing, Sallie Mae would expect to be asked to provide some form of financing to assist those individuals.

At that time, consistent with our legislation, consistent with discussions that we would have with all of the interested parties, including the Congress, and consistent with our franchise, we would try to make accommodation on the fairest basis to intermediaries, who would then make those accommodations to students.

But we have no requests for such loans at this time. I do not see where there would be any cost to the Federal Government, since this would not be a subsidized program. It would be private capital in support of these programs, if and when they do come about. And I would think that prudent bankers or Sallie Mae would set rates consistent with the marketplace, cost of funds, and reasonable profits. And I would think that if these products were attractive to banking institutions, they would compete to make these products available to the students, and they would certainly be no more costly than any other consumer credit that is available to the marketplace today.

Senator RANDOLPH. Mr. Chairman, should I come back to you now? I believe I have run over.

Senator STAFFORD. Why do you not go right ahead, Senator? I have finished the questions I wished to ask orally, and what others I have will be submitted in writing.

Senator RANDOLPH. Thank you, Mr. Chairman, and I will try to move very quickly.

I am advised that Sallie Mae, recently sought the concurrence of the Secretary of Education in your view that section 438(b)(2)(B)(i) of the act does not preclude payment of the special allowance to States on guaranteed student loans made by those States with proceeds of funds advanced to them by Sallie Mae?

The Secretary did not concur with your views. Now, what, Mr. Fox, was your reasoning for making that request? Had the Secretary agreed with your position? What would it have meant in terms of profit to either you or to the States? How much would have been the cost to the Federal Government?

How would his concurrence have helped provide more student access to guaranteed loans? It is a very involved question, I know.

Mr. FOX. It is one that is very important to us, and I would like the opportunity to speak for the record on that issue, Senator.

Senator RANDOLPH. Thank you, sir.

Mr. FOX. In the 1980 amendments to the Higher Education Act, it was recognized by the Congress and by others that there should be a very diverse delivery system in support of student credit and that institutions should have the broadest array of options as to where they could get their funds.

It was noted that the State agencies who were financed primarily through the issuance of revenue bonds were facing higher costs, and indeed the inability to issue longer term securities which were necessary to match the maturity of the longer term assets they were acquiring.

The ability to lend moneys that Sallie Mae raised in the private capital markets to State agencies was implicit in the 1980 legislation. What this did was give the States more options and more flexibility in their fund-raising dealings so that they would have more opportunities to raise funds in support of their State programs.

So, if one alternative means of financing was foreclosed because of poor market conditions or because of the inability of the market to purchase their securities, or whatever, they had an additional option to borrow. This can only be beneficial to the States who have that option, and it can only be beneficial to the students who therefore get the benefit of those dollars through accommodations made by the very strong State networks that exist in 25 States that support primary and secondary lending.

There was no requirement that anybody had to borrow. There was no requirement as to what price it had to be. All it said was that the States were given an additional alternative means of raising capital in support of those State programs. That can only be to the benefit of all parties.

The Secretary of Education, in reviewing that legislation with counsel, took note of the fact that certain changes were made in legislation relative to the States' ability to sell revenue bonds and the income which they received if they were to finance their programs through tax-free securities.

The result was that it was unclear in their minds as to whether a borrowing from us, of fully taxable funds would result in a full special interest allowance or a half special interest allowance. It had been stated in the law that if they borrowed on a tax-exempt basis, they were not going to get the benefit of a full special interest allowance but would have their income cut by the Federal Government.

There is nothing in the law that says that we cannot make this loan to the States, and there is nothing that says that they cannot be fairly reimbursed and fairly compensated, as all other borrowers and all other lenders in this program are reimbursed. But because the law was not as clear as the Department of Education would have liked, they said that additional legislation would be necessary to clarify and assure that that authority existed.

Senator Pell and Senator Stafford wrote a letter to the Secretary pointing out that the legislative history, the report language that accompanied the legislation, and the legislation itself was very clear that this authority to the States to be able to borrow from Sallie Mae and to get the full special interest allowance was clear. The Secretary has reiterated that he feels it is unclear and that it would take statutory changes through a technical amendment to clarify the matter.

In their technical amendments, they have proposed clarifiying language. We heartily support that. There is nothing in there that suggests any profitability to either the States or to Sallie Mae. All it says is that there is an additional source of funding available to the States to aid them, at their choice and option, in making accommodations to students.

Senator RANDOLPH. I know that you mentioned Senator Pell in the colloquy that we have just been having, and I am gratified to

acknowledge that his leadership in the matter of Pell grants, student loans and benefits to our student population at the higher institutions of learning has been of a very high order.

Mr. Fox, there is a specific authority in section 439(q) of the act, and I am pointing it out so the record will indicate it, under which Sallie Mae may itself make these loans where eligible borrowers are seeking but are unable to obtain loans.

Under that provision Sallie Mae, in particular, may respond to that unavailability of loan funds. Has the Secretary of Education encouraged you at any time to consult with him or his staff on the possible implementation of that lending authority?

Mr. Fox. We have never received any specific request from any State or institution to exercise an authority within that State.

In response to us relative to the loans to States matter, the Secretary indicated that if a State was unable to raise funds in support of its program through the sale of revenue bonds, and if they were unable because of his ruling relative to loans to State programs to borrow from us, and if as a result of that, there were no funds or inadequate funds available within that State, it would be appropriate for Sallie Mae to exercise that provision to make sure that there was adequate capital.

We have responded that if there is a bonafide and strong delivery mechanism in the person of a State agency, it would be totally inappropriate for Sallie Mae to be either replicating or duplicating the facilities of that entity; that we would much prefer to work through the existing infrastructure which has so well served the guaranteed student loan program in the past. And we have not undertaken any action to implement that authority in any way.

Indeed, with the strength of the guarantee State agencies and the fact that it requires a request of a State and the approval of the Secretary, rather than unilateral behavior on the part of Sallie Mae to exercise that provision, we do not anticipate that that provision will be exercised under the current processes or programs, as we see them, in the foreseeable future. We have no interest in pursuing that as long as there is a strong and viable alternative structure already in place, and we have so advised the Secretary.

Senator RANDOLPH. The question I am now asking—have you answered it? If implemented, what would actually occur in those States where loan funds were unavailable or deemed to be unavailable?

Mr. Fox. My understanding of that provision, which goes back to the 1980 legislation, was if, on a geographic basis, there were no funds available—there was a definable, legitimate need and it was recognized within the State that there was this need, and that need was conveyed to the Secretary, who then made a ruling that there was a need—under those circumstances, with the support of the State and with the support of the Secretary, Sallie Mae could be invited in to become a retail banker in that State to make accommodations.

Now, Sallie Mae is not a retail institution. It does not have a large staff; it does not have a large infrastructure.

Senator RANDOLPH. What is the staff?

Mr. Fox. We have about 450 employees. That is about one-tenth of what a banking institution our size would have.

We have no desire to set up a large retail banking network either in a State or nationwide. We would much prefer to work with existing institutions. But were it to come to pass, that is the way in which we understood the process would work.

Senator RANDOLPH. So, if this unavailability of which I have spoken were in effect, what would be the effect on that State guarantee agency?

Mr. FOX. It is my understanding that only if such an agency either did not exist or no longer had the capacity to function would that State, in the first place, be requesting assistance.

Senator RANDOLPH. I want to state for the record to you, Mr. Chairman, that Mr. McCabe and Mr. Fox have been very helpful to me, and I think in the printed record of this hearing and the further consideration that we give to this subject matter, there will be those additional clarifications as specified, not that there has been any attempt, I say, to hide any matters.

But I just trust that through the maze—I use that word—we can come to a clearer understanding of what has been done and what perhaps needs to be done in the future. We are distressed, many of us, who are intensely interested and deeply concerned about the colleges as they open their doors this fall, that for one reason or another—but, certainly, a very major reason is that the benefits that the students have felt were accessible to them are being cut and are, in many instances, being eliminated.

From college presidents, especially, in West Virginia I received most discouraging information about the reduced student enrollments that will come in the next few months.

Do you feel that they perhaps are frightened unnecessarily, or is the situation as acute as they indicate to me?

Mr. FOX. Senator, I sit on a number of panels and groups of people who try to examine the problems associated with the education delivery system, and the like. Yes, I do hear in a number of instances that institutions are feeling some of the pain.

Some institutions, I think, will do better. Many institutions may indeed find a lessened number of students available to them. We will not really know the full impact of this for another 90 days. The Congress has to wrestle with the issue of how to appropriate funds in support of higher education.

We are one of the participants in the private sector who tries to support the congressional intent. The participants include banks, as well as other financial institutions. I think all of us feel a very strong need, consistent with the law, to do the best we can in support of the postsecondary education system.

Mr. MCCABE. I might add to that, if I may, Senator, that we at Sallie Mae do not feel that it is our job to make policy; that comes from up here. We do, however, feel that we have if you will, a technical competence that we would like to share with you whenever you want to call on us. We think we can help in showing, perhaps, how some idea or legislative approach may work out in the marketplace. And to that extent and to the extent we can be, in a sense, technicians, we will respond to any call you make of us.

We do like the notion, though, of staying away from policy. We do not want to be presumptuous in that regard; it is not our role. We are here to help, in that sense, as technicians. While we will

not bother you and we will not be knocking at your door unduly, if you or any of the committee or the staff feel the need for this technical help that we might be able to give, we will respond promptly.

Senator RANDOLPH. Mr. Chairman, both these gentlemen, Mr. McCabe and Mr. Fox, have been very helpful to me, and I am sure to you and members of the subcommittee. Thank you very much.

Senator STAFFORD. Yes, I think they have, to the entire subcommittee and the full committee.

The Chair is happy to see that the ranking member of this subcommittee, my dear friend, the able Senator from Rhode Island, Senator Pell, is here. Senator, we kept the record open for an opening statement to be either given by you or to be inserted as you wish, and if you have questions, please go ahead.

Senator PELL. Thank you very much, Mr. Chairman. I have no opening statement. I do have a couple of questions I might ask.

Senator STAFFORD. Certainly.

Senator PELL. I have a great regard for Mr. Fox and Mr. McCabe and the Sallie Mae operation.

I believe some critics however, have contended that you will not purchase small portfolios. What is the range of portfolios that you do purchase, and what is the average size?

Mr. FOX. I think that is a bit of mythology that has grown up over the years, Senator. The median sized portfolio that we have purchased since inception is between $300,000 and $400,000, which means we have done as many transactions below that size as above. That translates into a median size transaction of approximately 75 or 80 student loans—borrowings for 75 or 80 students.

We have actually purchased as small a loan portfolio as one note for $1,000. The largest transaction we have ever done is in the hundreds of millions of dollars with nationwide lenders of last resort.

By and large, the bulk of our institutions are smaller, local institutions who provide credit in their communities. In addition to our normal programs, we have community lender programs that give even more attractive opportunities to participate in our program and availability to smaller institutions.

And I think if you desire it, we can provide you with more specific detail about who our customers are, and the like. But, clearly, we have had marketing representatives visiting more than 10,000 financial institutions around this country. We have done business with about 1,500, and the bulk of our business in terms of numbers of transactions is actually with the smaller, more modest-sized institutions of a more regional or community nature.

The bulk of the dollars come from the bigger institutions that are more statewide in nature, whether they be banks or State agencies. But we have made every effort to reach out to smaller institutions all over the country, have attended the meetings of the small bank associations on a statewide basis, and have made it our business through our advertising and promotion and through some of the materials which we have made available to your staff and which can be made available to you, to reach out to the smaller institutions for a number of years, and I think the record bears that out, sir.

Senator PELL. Thank you very much. Now, I understand that Sallie Mae is authorized to act as a lender of last resort. Are there

any instances where you are doing that, where the State agencies or nonprofit organizations have not been able to meet the demand and you are acting as a lender of last resort?

Mr. Fox. Generally speaking, we have financed those State agencies or those banking institutions who have undertaken the role of lender of last resort in their geographic areas. There have been a couple of instances where, because of historic problems or the inability or the lack of willingness of the banking system to provide accommodation, we have actually stepped in.

An example, Senator, was here in the District of Columbia, where practically no loans were made for a number of years, which was very unfortunate. Working with the Department of Education and a local bank, we put together a program that made available to those who either went to school in the District or who were residents of the District a lender of last resort program, the Department doing some of the work, we doing some of the work, and a local bank issuing a check, and Sallie Mae buying those loans immediately thereafter.

Now, admittedly, this is stretching the secondary market a bit. But at what was actually a losing proposition for the organization and at high cost to the bank and the Department of Education, we put in place a program which very rapidly generated about $30 million worth of loans.

We were very pleased that shortly thereafter, a guarantor—the Higher Education Assistance Foundation—did step up and was willing to undertake the responsibility of putting a program in place here after this had been created. And then a State agency was created that has undertaken that responsibility, and we have backed away because we were no longer needed.

We have worked with the banking system in California in much the same way in getting them back into the program, where that State had a practically nonexistent program 4 or 5 years ago after some difficult experiences.

Senator PELL. I see what you are driving at. You make sure that students can get loans, but in how many instances today would Sallie Mae be the lender of last resort?

Mr. Fox. We do not originate any loans at this time. We never have originated any loans. We always work through an intermediary. To the extent that we work with the appropriate State authorities and the appropriate lending institutions in that State, we try to help and accommodate by providing capital, know-how and support. But we do not make any loans on a direct basis.

Senator PELL. But you are authorized, are you not, to do so? Are you authorized to be a lender of last resort?

Mr. Fox. Under the 1980 legislation, were there to be inadequate support within a State or were there to be inadequate support from an agency within that State, at the request of that State and with the approval of the Secretary of Education, we may be invited in. There is no way, on a unilateral basis, that we can do that, and have never done so nor been asked to do so.

Senator PELL. Thank you very much. Now, finally, in your loan consolidation program—I think it is called OPTIONS—I notice that the consolidated rate on both the NDSL and GSL is intended to be 7 percent. Now, will this not place the youngster who has both an

NDSL and a GSL loan at a disadvantage, because the NDSL rate is 3 percent and the GSL rate is 7 percent?

I was just curious why you were not averaging these different rates rather than taking the higher?

Mr. Fox. The law specifies that we are to make the consolidated loan at a 7-percent rate. The law had not anticipated that the GSL would go to 9, and we are supporting legislation which is among the technical amendments from the Department of Education that suggests that the refinancing is at the rate that the student had under the GSL program—either at 7 or 9.

We are not actively soliciting, trying to get a cheaper rate for a student than they otherwise might have had. The student has the option of consolidating all or part of their indebtedness. The benefit to the student is not so much that there might be a rate that is better or less than they otherwise had. The benefit to the student is that they can manage, perhaps on a graduated basis or perhaps on an extended basis, their debts, and so their total out-of-pocket costs can be better managed relative to their income.

They get the ability to extend payments over a longer term or the ability to perhaps pay a lesser amount of principal back in the early years as against the latter years. It is a cash management device, but for the student, it is not so much that they will save a few dollars in interest, but it will aid them in managing their affairs.

To the Government, it means a lesser probability of default. It also means that NDSL money that otherwise might not be available to a school is recycled back to that school to be further lent to other needy students at a point in time when they need that accommodation. Finally, it is using private capital in support of the whole mechanism.

It also means that a lot of small loans are consolidated into a single loan so that there is only a single cost of administration rather than multiple costs of administration for each one of these loans. It also removes from the school the necessity of servicing loans for which they are not necessarily well prepared.

It was not solely to give an interest accommodation. It was for a variety of purposes to improve the entire program that this program was created, sir.

Senator PELL. Thank you. Thank you very much, Mr. Chairman.

Senator STAFFORD. Thank you very much, Senator Pell.

If there are no further questions at this time, the Chair for the subcommittee wants to thank you both, Mr. McCabe and Mr. Fox, for your assistance to us in understanding Sallie Mae. We look forward to availing ourselves of your advice in the future if we feel we need it. Thank you very much.

Mr. MCCABE. Thank you.

Mr. FOX. Thank you, Senator; thank you for the opportunity.

Senator STAFFORD. The next and final panel this morning will be the State guarantee agencies panel, consisting of Mr. Richard C. Hawk, president of the Higher Education Assistance Foundation of Overland Park, Kans.; Mr. David Longanecker, deputy executive director, Higher Education Coordinating Board, St. Paul, Minn.; Mr. Paul P. Borden, executive director, Higher Education Assistance Authority of Frankfort, Ky. And the Chair is very happy to

see that Mr. Ronald Iverson, director of the Vermont Student Assistance Corp., is also here.

The Chair is prepared to ask you if you have some preferred order in which you wish to speak. If not, we would start with Mr. Hawk, and go then to Mr. Longanecker, then Mr. Borden, and then Mr. Iverson.

Is there any preference, gentlemen?

[No response.]

Senator STAFFORD. Hearing none, Mr. Hawk, I guess you are the leadoff witness.

STATEMENT OF RICHARD C. HAWK, CHAIRMAN OF THE BOARD, HIGHER EDUCATION ASSISTANCE FOUNDATION, OVERLAND PARK, KANS.; DAVID A. LONGANECKER, DEPUTY EXECUTIVE DIRECTOR, MINNESOTA HIGHER EDUCATION COORDINATING BOARD, ST. PAUL, MINN.; PAUL P. BORDEN, EXECUTIVE DIRECTOR, HIGHER EDUCATION ASSISTANCE AUTHORITY, FRANKFORT, KY.; AND RONALD IVERSON, DIRECTOR, VERMONT STUDENT ASSISTANCE CORP., WINOOSKI, VT., A PANEL

Mr. HAWK. Thank you, Mr. Chairman. If I may, I would like to take just a moment to commend this committee for its diligent and notable efforts in maintaining the guaranteed student loan program. This is not easy in periods of pressure for reductions in the budget. There is very little that is more important than the preservation of financial access to postsecondary education for the future of this Nation, and this committee does deserve to be commended. That needs to be recognized. The leadership has been superb, and I think you need to know that all of us appreciate that genuinely.

Senator STAFFORD. Thank you, Mr. Hawk. For the committee, we do appreciate those very kind words. They will act as some salve to a few of the scars we have picked up in the last 18 months down here.

Mr. HAWK. I might also say that we have been especially pleased at the bipartisan approach of the committee with respect to this. Of course, I feel particularly indebted to Senator Randolph—his able representation not only in the State of West Virginia but his diligence and humane efforts to meet the genuine needs of people.

Mr. Chairman and members of the committee, at the outset I wish to state clearly my belief that the Congress should adopt the proposed amendment with respect to bankruptcy for the Student Loan Marketing Association, and that the Congress should take any other reasonable actions which will facilitate continuing financial viability of the association. I also believe it to be appropriate for the Congress to monitor the association to assure that its activities are consistent with the intent of Congress.

Availability of a national secondary market as provided by the Student Loan Marketing Association is absolutely essential to the guaranteed student loan program. Although several ingredients are necessary for assuring adequate funding and liquidity of funds for access to loans throughout the Nation, the national secondary market is one of the most important, if not the most important, of those ingredients.

Given the importance of the national secondary market function performed by the association, any attention which the Congress chooses to devote to the association should be focused in the context of assuring that the national secondary market operates effectively in accordance with the objectives of Congress for the guaranteed student loan program. Any congressional attention designed to inhibit the effectiveness of the national secondary market would be misguided and to the detriment of the guaranteed student loan industry and its various constituents.

By some standards, the Student Loan Marketing Association is remarkably successful and effective. The association's success is reflected in the substantial volume of loans with which the association is involved either as a purchaser and holder or as a financier through warehousing-type arrangements.

The growing number of both lenders and guarantee agencies involved with the association is another indication of success. Furthermore, in making its contribution, the association, like guarantee agencies and lenders, has had to overcome the difficulties associated with program complexity and frequent changes in the program.

On the other hand, the association has not as yet achieved the full potential of a secondary market which can meet the needs of all parties in most circumstances. Some dissatisfaction with the association prevails in spite of the association's success, and some who have pursued transactions with the association have been sufficiently disappointed as to become critical of the association.

Some such disappointment and criticism must be expected, because no organization can satisfy all parties with which it seeks to do business all of the time. Some of the dissatisfaction must be blamed on errors of the association, some must be blamed on errors of the complaining parties, and some must be blamed on honest misunderstanding.

Perhaps even more important than errors or misunderstanding on either side is an underlying problem of differential perceptions regarding the association's proper role and the extent to which the association should be relied on for some kinds of assistance.

For example, from the perspective of a State guarantee agency or statewide lender of last resort seeking availability of funds to assure access to loans within a State, the association might be expected to agree to purchase loans at whatever price might be necessary to facilitate viable financing for loans.

Conversely, from the perspective of the association, the proper expectation might be for the association to commit to the purchase price of loans according to whatever price may be necessary for the association to both meet servicing costs and achieve an appropriate profit objective, whether or not the price to be paid for loans is sufficient to assure a viable financing arrangement and availability of loan funds in a State.

To state the issue differently, the association's perspective in attempting to establish itself as a financially sound organization may conclude that it can appropriately pay a price of par—that is, outstanding principal balance—for an interim loan only if the average borrower indebtedness for a loan portfolio is at least $4,300.

From the perspective of a guarantee agency or a lending organization seeking to meet the total loan needs in a State, a $4,300 average indebtedness to qualify for a par purchase and sale price may seem totally unreasonable and even unattainable. In some instances, such a purchase and sale price requirement could necessitate either selling loans at a substantial discount, which inhibits viability for financing student loans, or, on the other hand, adoption of minimum loan requirements, which would cause some students to borrow more than they wish to borrow, or cause other students not to be able to borrow at all in order to achieve the average borrower indebtedness prescribed by the association.

The conflict between the need to meet the association's borrower indebtedness requirement and the desire to meet the needs of all students, including those whose loan amounts are relatively small, was made more acute when the Congress adopted the expected family contribution requirement for borrowers with family incomes exceeding $30,000, thereby reducing the maximum loan amount for some borrowers. This conflict would have been even more severe if the Congress had adopted the administration's recommendation for imposing the expected family contribution on borrowers at all income levels.

The cost of acquiring and servicing student loans is likely to continue to increase, and the Congress is likely to be faced with additional proposals to reduce the cost of Federal subsidies for student loans. If the Congress should seek more budget reductions through further limitations on amounts which students may borrow, thereby causing average loan size to decline while the association's average indebtedness requirement increases to correspond with increasing costs, the conflict may well become critical, if it is not already.

Another example of dissatisfaction growing out of differential expectations is the association's response to congressional action establishing new programs. When the Congress elects to establish a program of loans to parents of undergraduate students, those guarantee agencies and lenders which have made a commitment to attempt to meet loan needs within a State according to whatever terms the Congress prescribes feel compelled to offer parent loans as quickly as possible.

Many of these organizations believe that the association should have a similar responsibility to assist them in meeting loan needs to the fullest extent feasible according to all terms prescribed by the Congress. The association, on the other hand, may feel that the need to proceed immediately on any program initiated by the Congress has less importance than a responsibility to proceed cautiously in determining whether or not any new thrust initiated by the Congress should have the support and assistance of the association.

The luxury of choosing which needs to meet or which programs to implement causes resentment toward the association by organizations which do not enjoy such luxury, just as the association's freedom to establish its own pricing schedule for loan purchases causes some resentment.

The association is one of the few organizations involved in student loans which is free to change the yield or return on loans by changing its purchase pricing schedule. Similarly, the association is

free, in the absence of a specific mandate by the Congress, to decide if and when it will provide certain kinds of service, such as a secondary market for parent loans.

The luxury of influencing the return on loans to be held and the luxury of deciding if and when to provide services related to new congressional thrusts is not necessarily inappropriate and may, in fact, contribute to long-range viability of a continuing national secondary market. However, this freedom is a natural irritant to organizations which perceive themselves as having a responsibility which precludes any such freedom for their own organizations.

Similar resentment sometimes occurs because of the association's ability to minimize its own risk by imposing continuing risks on organizations to whom it provides service. An example of risk transfer is the seller servicing arrangement, under which the association agrees to purchase loans with the stipulation that the originator of the loans accept responsibility for servicing those loans sold over the life of the loans at a predetermined price, such as 1 percent or 1¼ percent of the principal outstanding per year.

It is true that transferring the risk of increasing loan servicing costs from the association to the seller of loans may permit the association to pay a higher price for a loan portfolio than the association would be willing or able to pay if it had to assume the risk of uncertain increases in servicing costs.

Nonetheless, the originator having no place to go to achieve liquidity other than to the association, can feel that continuing risks with respect to the portfolio to be sold is a high price to pay for use of the secondary market, especially in view of other fees which the association charges for granting a commitment to purchase loans.

Potential for resentment also occurs when the association treats individual guarantee agencies and lenders differently. Within the total group of guarantee agencies and within the total group of lending organizations, there does exist significant variation in terms of financial strength and quality of programs. In view of this reality, the association probably is justified in dealing with the various organizations differently, in spite of the political problems associated with differential treatment.

Programs associated with the Higher Education Assistance Foundation have experienced both the benefits and the disadvantages of differential treatment at different points in time. In the early stages of development, some financing had to be done without the support and assistance of the association. As the foundation programs grew stronger, substantial financing was done with the support and assistance of the association.

Recently, financing has been done without the support and assistance from the association because the foundation's programs grew strong enough to permit more favorable terms on commitments from commercial lending institutions than could be obtained from the association.

It should be noted that the association stands to benefit from greater uniformity in requirements and procedures among the many guarantee agencies whose loans may be purchased by the association. Given the desire of guarantee agencies to adopt and maintain those policies and procedures which are judged by them to be most sound from the perspective of the individual agency, ef-

forts of the association to stimulate uniformity is an obvious source of tension.

This is particularly so when objectives of the association appear to change or are not clearly or accurately perceived by guarantee agencies. Under such circumstances, natural suspicions arise about the association's effort to achieve greater uniformity in guarantee agency policies and procedures.

Finally, differential perceptions regarding expansion of the association's role can create conflict, misunderstanding, and even antagonism. Such was the case in 1980 when the amendment emerged and was passed granting authority to the association to originate loans under certain circumstances.

From the perspective of the association, incorporation of some originating authority was a natural expansion of the association's role which could facilitate continuing effectiveness and improvement of the guaranteed student loan program, in addition to strengthening the association.

From the perspective of other student loan organizations, the entry of the association into student loan activities other than secondary market activities was viewed with alarm for several reasons.

First, the expansion of the role came as a surprise, and many do not accommodate change easily, particularly when it comes about on short notice without advance warning. Second, there are those who saw ample opportunity for improvement in the secondary market activities and were reluctant to see the association's attention diverted from the critically essential secondary market function.

Third, the association sought to have the origination for purposes of loan consolidation be an exclusive function of the association, to the possible disadvantage of both guarantee agencies and lenders who could experience a decline in average loan size, as the association would acquire the larger loans from a portfolio through origination of a new loan with the guarantee of the Department of Education.

Fourth, the potential dependency of all other student loan organizations on the association for the secondary market caused fear among many of those organizations that with the authority to originate loans, the association could be inclined to offer less favorable purchase terms because absence of loan availability from other lenders might give the association a more profitable opportunity to step in as a lender.

There were also some concerns about cost to the Federal Government of some kinds of origination by the association, but of all the concerns, the most serious probably has been the one relating to the leverage which the association has on all other organizations needing the service of a national secondary market, and the potential of future abuse of that leverage as the association's role is expanded to include functions previously reserved for other organizations.

In summary, Mr. Chairman, the association has made obvious contributions to the guaranteed student loan program and has achieved an enviable record of financial success. Nonetheless, some dissatisfaction exists as a result of differential perceptions and ex-

pectations with respect to the association's objectives and responsibilities.

In addition, authority for expansion of the association's role beyond secondary market activity has been met with mixed reactions, including genuine concern about any role expansion which could be viewed as competitive with other student loan organizations, in view of the potential leverage of the association on the other organizations.

As the Congress considers additional action with respect to the association, my own recommendation would be that such action should be directed toward, No. 1, assuring the continuing financial viability of the association to perform successfully in providing an effective national secondary market, which is so critical to the guaranteed student loan program; and, No. 2, clarifying the congressional expectation for the association and thus diminishing differences in perception between the association and other organizations regarding the association's objectives and responsibilities in supporting and assisting other organizations through secondary market activities.

In any such action, I would urge the Congress to exercise great care not to diminish the potential for continuing advancement of the association, and not to impair the long-range effectiveness of the association in providing a critically necessary national secondary market function.

Overall, the contributions of the association have been substantial. There is room for improvement, but the association deserves your support in strengthening and improving its effort to make continuing contributions.

Thank you, Mr. Chairman.

Senator STAFFORD. Thank you very much, Mr. Hawk.

If the Chair could see the clock at the other end of the room, the Chair would realize we were approaching 12, at which time, technically, we become illegal. Unfortunately, I cannot see the clock that well at the moment, but I would ask the rest of our witnesses, if they can, to summarize their testimony as briefly as is consistent with getting points across.

Mr. Longanecker, your full statement will be placed in the record as if read. If you could summarize, it would help us at this point.

Mr. LONGANECKER. Fine; I would be happy to do that, Mr. Chairman.

I am pleased to be here. I am going to try to briefly outline three points of why secondary markets are so important to a tax-exempt lender such as ourselves; why we are concerned about Sallie Mae's new authorities, which we think create a conflict of interest within that organization; and what we think you can do to help remedy the situation.

There are two reasons why a secondary market is so important to a tax-exempt association such as ourselves—to provide debt security and fund liquidity. The first of those is debt security. Under most market conditions, our debt offerings need some security in addition to what we have simply through loan repayments and the Federal guarantee. Without that security, we simply cannot enter the market under favorable terms.

The second part is fund liquidity, which has become particularly important in the last few years because the length of term for a student loan is quite long—generally in the range of 8 to 12 years. But we have been able to go to the market, and borrow only on a relatively short-term basis—generally in the range of 3 to 5 years—which means that we need some form of liquidity to turn our funds over.

The secondary market provides us with both of those functions—debt security and fund liquidity—by providing a commitment to purchase our loans if and when we need to sell them. Unfortunately, we are most dependent on a secondary market during periods of fiscal distress or uncertainty.

We have had a long relationship in the Minnesota program with secondary markets and with Sallie Mae in particular. However, for more than a year now, we have not been able to negotiate successfully with Sallie Mae either an extension or a successor to our previous agreements. As a result, we have had to turn to private lending institutions, where we have been able to secure limited commitments on terms that were more responsive to our immediate needs.

Our dilemma, however, is that as fiscal conditions continue to change, we are not certain that we will have access to these private lending institutions, and the terms that Sallie Mae has been offering are not very favorable to us.

So, it is with that background that I would like to share our major concern. Now, we have a number of concerns; I am going to only discuss our major concern, which is the potential conflict of interest that we believe is presented by allowing Sallie Mae to be both a lender and a secondary market.

We are concerned that the same competitive principle that guides Sallie Mae's original purpose, when applied to the additional authorities, could undermine Sallie Mae's interest in remaining active as the secondary market for our type of lender. In fact, in practical terms—and Mr. Hawk mentioned this—the question is whether Sallie Mae can make greater profits by exercising its new authority as a lender or whether it can make greater profits by continuing to serve other lenders such as ourselves as a secondary market.

If Sallie Mae decides that it is more profitable and in its best interests as a corporation to be a lender, it could demand terms and conditions in the secondary market for us that would undermine our statewide direct lender program. This potential conflict of interest and purpose would, at least from our perspective, certainly bode ill for the efforts of a State to provide credit for students.

We believe that there are a number of ways that the Congress could go about remedying this. Our preference would be to essentially remove the conflict of interest by rescinding Sallie Mae's recently acquired direct lending authority. If this were done, Sallie Mae would no longer have to weigh the benefits of being a lender versus a secondary market when making corporate decisions on where to invest its resources.

While rescinding that authority would eliminate one potential lender of last resort, it would also reintroduce some incentive for Sallie Mae to use its secondary market functions to help underserved areas develop strong private and State lenders. As long as

Sallie Mae retains its direct lending capability, there is not much incentive for it to help others become better at it.

We are concerned that simply requiring that Sallie Mae go to the Education Department and/or to the State to receive their blessing, as is currently required, is not a sufficient condition to resolve our concern because it does not remove that conflict of interest. Rather, the financial viability of the State programs would remain dependent on Sallie Mae as a secondary market, and the absence of such support could leave the States in the position of having no alternative but to go and ask for Sallie Mae to come in as a potential lender.

A final remedy, which I believe should be adopted no matter what other action is taken, is that Congress should establish a regular procedure to oversee Sallie Mae and its operations. While Sallie Mae is a for-profit organization, it is not a wholly private concern. It was established by Congress to provide a public service, and Congress has the responsibility to insure that this organization continues to perform the services for which it was created.

Mr. Chairman, I believe this hearing and your subsequent deliberations provide a unique and constructive forum to clarify to the staff and the Board of Sallie Mae and to the community of lenders what Congress intends as the priority needs for Sallie Mae. This effort can establish a basis for future oversight and evaluation of Sallie Mae's performance—an evaluation that I would suggest should be based on preestablished performance objectives for Sallie Mae. Without such an effort on the part of you and your colleagues, Mr. Chairman, I fear a continued period of confusion characterized by needs inadequately addressed, unproductive tension, and conflicts of interest. This would ultimately place in jeopardy much of the GSL program, particularly that part that has been responsive to the needs that the traditional commercial lenders have been hesitant or unwilling to meet.

I thank you for the opportunity to be before you today.

[The prepared statement of Mr. Longanecker and responses to Senators Randolph and Hatch questions follow:]

STATEMENT OF DAVID A. LONGANECKER

Mr. Chairman and Members of the Committee, I am David Longanecker, Deputy Executive Director of the Minnesota Higher Education Coordinating Board. I am particularly pleased to be here today because it is my first opportunity to appear before you representing the Coordinating Board. Until last November, as some of you may remember, I served this committee and the Congress as the Education and Training Unit Chief of the Congressional Budget Office's Human Resources and Community Development Division.

This testimony is presented in three parts. First I would like to explain what the Coordinating Board is and why it is so concerned about secondary markets for student loans. Second, I would like to discuss our specific concerns about the Student Loan Marketing Association's role as a lender and secondary market for student loans. And finally, I would like to offer some suggestions on how you might be able to address our concerns.

The Coordinating Board in Minnesota is an 11-member lay board, which represents the public at large in coordination of post-secondary education in our state. The Board has broad planning and research responsibilities as well as administrative duties. We are responsible for a number of state funded financial aid programs as well as the second resort direct loan program under the federal Guaranteed Student Loan Program.

Our direct student loan program is one of the largest single tax-exempt lenders in the nation; disbursing approximately $90 million in the fiscal year just recently completed. Our program is designed to provide access to loans for any eligible Minnesota student who is unable to obtain loans from commercial lenders. As such we have made between 45-55 percent of the loans in Minnesota since the inception of our program in 1974. During this period we have made approximately $362 million in loans.

The Minnesota program is capitalized by the sale of tax-exempt revenue bonds. Since April 1974, the Board has issued bonds of $492 million and today has outstanding obligations of $327 million. This debt is the sole obligation of the Coordinating Board and is not backed by either the credit or taxing power of the State. We believe our program is a prime model of successful management and use of the tax-exempt market for a wholly public purpose. Our students and post-secondary institutions are absolutely dependent upon the timely availability of this credit as an integral part of their financial aid packaging. Without the availability of these loans many of our students would be unable to attend the program best suited to their ability and aspirations. The result would be both distortions and declines in enrollments.

I. THE IMPORTANCE OF A SECONDARY MARKET TO TAX-EXEMPT LENDERS

The ability of the Coordinating Board to fund a student loan program of last resort as directed by the Minnesota Legislature, is critically affected by the presence of an effective and reasonable secondary market for student loans.

For a tax-exempt lender the secondary market serves simultaneous dual functions: debt security and fund liquidity.

I think most would classify the Minnesota program as financially mature and stable. Nevertheless, it is apparent that under most market conditions our debt offerings need some security in addition to scheduled loan repayments and current guarantees. Without some additional security, our bond ratings would drop, which would no doubt jeopardize the financial viability of our program. In our judgment this need for security can most effectively be met through a long-term relationship with a secondary market for student loans. And if this need exists for a mature and stable program, I am sure

you can understand how critical the need is and will continue to be for programs just beginning to use tax-exempt capital or for those in the process of maturing.

Providing fund liquidity has become a particularly important secondary market function in recent years because of the difficulty to market long-term bonds at reasonable rates. Although the student loans generated through the tax-exempt borrowing are generally repaid over a reasonably long period of time (8 to 12 years), market conditions over the last few years have restricted tax-exempt lenders to short-term borrowing (3 to 5 years). As a result, the availability of a secondary market, flexible to program circumstances, has been absolutely necessary to allow lenders such as us to remain active.

A secondary market provides us with both debt security and fund liquidity through a commitment to purchase loans if and when the program needs to sell, whether to meet debt service requirements or to provide capital for additional loans. This commitment must be unequivocal and not subject to alteration with minor or short-term market fluctuations. Indeed, tax-exempt funded loan programs are most dependent upon secondary market services during periods of general market distress or uncertainty.

The Minnesota program has had a long relationship with secondary markets and with Sallie Mae, in particular. We have had dealings with Sallie Mae since 1976 and in 1979 we signed an agreement with Sallie Mae which was designed to cover up to $200 million on loans made from our program. We have used up the amount in that agreement and we have been unable to negotiate successfully with Sallie Mae either an extension or successor to it on terms that we feel are reasonable. Therefore, we have turned to private lending institutions where we have been able to secure limited commitment

agreements in terms more responsive to our needs. As fiscal conditions continue to change, however, we have no assurance that these options will remain available to us.

The 1979 agreement provided long term security and with it flexibility to effectively respond to student demand within a wide range of market conditions. Without such an agreement we will be increasingly dependent upon short term financing and the ravages of changes in short term rates. As our experience indicates, Sallie Mae can and has served as an effective secondary market for programs capitalized, at least in part, by tax-exempt debt, however, for more than a year now she has not offered services or terms responsive to our needs. I think it is also important to note that there is no indication that the private alternative upon which we have had to rely as an alternative will continue to be available.

II. CONCERNS

With this background, I would like to share with you our specific concerns about the future role of the Student Loan Marketing Association as the principal secondary market opportunity for student loans in the nation.

I must stress to you that I speak today not as an investment banker or financial analyst or as a bond counsel, I speak as one who has responsibility to the Board, the Minnesota Legislature and more than 50,000 students annually to ensure that sufficient funds are available for students and their families to pursue the post-secondary education of their choice. Thus, my perception and concern is a very practical one, not confused by the intricacies of the bond market or the legalities of bond sales. It is how I am going to meet the needs of Minnesota students and families at prices and terms that are reasonable and that protect the long run integrity of the program and the public interest.

At the outset, then, let me state an assumption that I believe to be fundamental to the concerns of the committee--that is, that the central purpose of the Student Loan Marketing Association is to offer liquidity to commercial and direct lenders.

It was within this understanding that a year ago Dr. Ingle, the Executive Director of the Board and his colleagues from a number of other states expressed their concern about the additional authorities and responsibilities for Sallie Mae that Congress ultimately adopted. While we do not propose to reopen the debate about the individual amendments, we continue to believe that the question remains as to whether the additional authorities and responsibilities are directly in conflict with the central purpose of the Student Loan Marketing Association? And this committee should be commended for readdressing this issue.

As I explained earlier, the presence of an effective secondary market for student loans is absolutely essential if it is our intent to provide credit to students and families. Furthermore, we believe that the central and original purpose of Sallie Mae was laudible and that the underlying working assumption that Sallie Mae should function in the competitive market is sound.

Various aspects of Sallie Mae's new authorities continue to concern many state post-secondary education leaders. My discussion, however, focuses on one major concern--that the same competitive principle that guides Sallie Mae's original purpose, when applied to the additional authorities, could undermine Sallie Mae's interest in remaining active as a secondary market for tax-exempt lenders. In practical terms, the question is whether Sallie Mae can make greater profits by exercising its new authority to become a direct lender rather than by continuing to serve other lenders, particularly tax-exempt lenders, as a secondary market.

If Sallie Mae were to decide that direct lending was in its best interests, it could demand terms and conditions as a traditional secondary market that would undermine statewide direct lenders and private non-profit programs. This clear potential for conflict of interest could result in action quite contrary to the long-range purpose and intent of national policy. Having made this point, let me stress here that this is not a conspiratorial view of the world. I believe that the intentions of all involved from Sallie Mae to members of Congress are the best. I do not expect, however, that individuals will remain in their present positions forever. Furthermore, based on our experience to date, I expect that the conditions for funding the student loan programs will become more difficult. And if it is difficult for a mature program such as Minnesota's, it is going to be even more difficult for those programs that have evolved over the past few years, which I am sure is of particular concern to this committee. Thus, Sallie Mae's potential for conflicts of interest and purpose could bode ill for the efforts of states to provide credit to students, which I have understood to be Congress's intent since 1978.

III. REMEDIES

Congress can try in a variety of ways to remedy the conflict of interest between Sallie Mae's role as a profit-making corporation and its dual functions of being a direct lender as well as a secondary market for other lenders.

The most obvious remedy would be to remove the area of conflict of interest by rescinding Sallie Mae's recently acquired direct lending authority. If this were done, Sallie Mae would no longer have to weigh the benefits of lender vs secondary market activity when making corporate decisions on where to invest its resources. On the other hand, rescinding

Sallie Mae's lending authority would eliminate one potential lender of last resort in certain pockets of the nation where private lenders and state lenders have been unable to assure general access to the loans. Without direct lending authority, however, Sallie Mae would have reason to use its secondary market functions to help such underserved areas develop strong private and state lenders. In contrast, as long as Sallie Mae retains direct lending capability, there is little incentive for them to develop strong lenders because the absence of such lenders leaves them a potential new market as a direct lender.

Another possible approach to addressing the conflict of interest would be to allow Sallie Mae to enter a state as a direct lender only if invited in by the state. At present Sallie Mae need only document that a lender of last resort is needed and receive the Education Department's approval to become a direct lender. Imposing the additional requirement that the state invite Sallie Mae in would at least preclude Sallie Mae from assuming a role that the state intended to provide. We do not believe that this condition is sufficient to resolve our concern, however, because it would not fully remove the potential conflict of interest. The financial viability of state programs would remain dependent upon Sallie Mae as a secondary market, and the absence of such support could leave these states in the position of having no alternative but to invite Sallie Mae in as a lender of last resort.

The final alternative, I wish to discuss, is one that I believe should be adopted, no matter what other action is taken, and that is that Congress should establish a regular procedure to oversee Sallie Mae and its operations. While Sallie Mae is a "for-profit" organization, it is not a private concern. It was established by Congress to provide a public service,

and Congress has the responsibility to ensure that this organization continues to perform the services for which it was created.

Mr. Chairman, this hearing and your subsequent deliberations provide a unique and constructive forum to clarify to the staff and Board of Sallie Mae, as well as to the community of lenders, what Congress intends as the priority needs for Sallie Mae. At the same time, this effort can establish a basis for future oversight and evaluation of Sallie Mae's performance. And I would further suggest that you base your evaluation on pre-established performance objectives for Sallie Mae. Without such an effort on the part of you and your colleagues, Mr. Chairman, I fear a period of confusion characterized by needs inadequately addressed, unproductive tension, conflicts of role and interests, and ultimately the placing in jeopardy of that part of the GSL that has been responsive to the needs of students that the traditional commercial lenders have been hesitant to meet.

Thank you for the opportunity to join you today and to share my concerns with you. I would be pleased to assist you and members of the committee in any manner that will be helpful.

MINNESOTA
HIGHER EDUCATION
COORDINATING BOARD

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OFFICE OF THE EXECUTIVE DIRECTOR

November 19, 1982

The Honorable Jennings Randolph
U. S. Senate
3203 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Randolph:

I apologize for the delay in responding to your questions. This letter addresses each of your questions separately, although several relate directly to each other and are closely aligned with the concerns addressed in my August 12 testimony.

1. Should the subcommittee consider requiring Sallie Mae to retire all government guaranteed notes before it retires new notes it is selling to the public?

We do not necessarily believe that Sallie Mae should be required to retire all government guaranteed notes before any new non-government notes are retired. Such a requirement would require that either Sallie Mae retire all of its government debt well ahead of its current expiration or that it secure only long-term commitments from the public that would come due after repayment of Sallie Mae's government debt. While we may question the federal government's judgment in negotiating the current long-term debt agreement with Sallie Mae, we do believe it is now the federal government's responsibility to live with its commitment and not to impede Sallie Mae's transition to the use of private capital to maintain its operations.

2. Sallie Mae's new authority under (d) (1) (D) (Reconciliation) to undertake any other activity it determines to be in furtherance of the GSL program, or otherwise support the credit needs of students, has been criticized as too open-ended and thus poses a threat to state agencies.

Should we amend that section to include either a one-house veto authority over any implementation of this provision, or require Sallie Mae to wait 45 days before implementing any of its new authority under that subsection?

Rather than imposing a one-house veto over Sallie Mae's ability to implement its expanded authority or requiring a 45 day

waiting period, we suggested in our testimony that Congress rescind those authorities that create the inherent conflict-of-interest for Sallie Mae. Unless it is the federal intention to promote a privately controlled national student loan bank, there is no reason why Sallie Mae should have the protected privilege to operate both as a secondary market and as a lender, with the sole ability to consolidate loans.

We also suggested in the testimony that the Congress should establish a regular procedure for overseeing Sallie Mae's operations and activities. Indeed, these hearings have demonstrated how useful such oversight can be, both in better understanding Sallie Mae and in holding the corporation accountable for its actions.

3. For states that have established student loan authorities, allowing colleges to raise funds by issuing tax exempt bonds, backing such loans by pledging all or part of their assets, such as physical plant or endowments as collateral, and should such states (including West Virginia) find that it can not pay back its obligation under the bond when payment comes due--can state guarantee or lending agencies come to their assistance?

What about Sallie Mae's authority to deal in such uninsured loans--what might be the adverse effects on both the colleges or state agencies should this come to pass?

Minnesota has not established a student loan authority such as you describe, and the Coordinating Board is unlikely to support creation of such an authority in the future. While we cannot accurately address the possible relationship between such an authority and a guarantee agency, we can inform you that it would not be possible for the Minnesota State Student Loan Program to assist such an entity, were it to fail. Our existing bond covenants restrict the loan program's activities strictly to the Guaranteed Student Loan Program. Furthermore, even if it were possible, it is not clear that it would be prudent public policy for the state to cover these obligations.

As with guarantee agencies, we are not an appropriate party to address Sallie Mae's authority to deal in uninsured loans. We would be concerned, however, if Sallie Mae were to comingle such uninsured loans with insured loans, because the increased risk and ensuing costs of uninsured loans would increase Sallie Mae's cost of serving its traditional clients.

4. Do you agree that Sallie Mae's authority to go into a state, in agreement with the secretary, to provide student loan access if a determination is made that such state is either unwilling or unable to provide for student credit needs, is of concern because they are in a position to create that circumstance of "unwillingness or inability" on the part of a state agency because of state agency current, or future, dependency on the association to provide cash-flow? In other words, if Sallie Mae either refuses, or delays negotiation of agreements between it and state

agencies, it could create a lack of funds for student loans and thus create a situation where need is not being met--opening the way for Sallie Mae and the secretary to "order Sallie Mae into the state" to fill that need.

Is the foregoing the reason for the grave concern on the part of state agencies with that particular new authority for Sallie Mae?

How can that authority be amended to so restrict Sallie Mae as to alleviate state concerns?

Do you recommend outright repeal of that authority?

Would you accept a requirement that the authority include a consultation with state agencies or higher education entities before the secretary made a determination that unmet need existed in a state, before Sallie Mae is allowed in?

The central theme of our testimony was exactly the point addressed in this question. We feel strongly that providing Sallie Mae, which is a profit oriented corporation, with authority to act as both a secondary market and as a lender creates the opportunity and incentive for the corporation to enhance its profits by restricting the activity of other lenders. The financial viability of many lenders, public and private, depends upon the availability of Sallie Mae's secondary market activities, and the absence of such support could leave no alternative but Sallie Mae as the lender of last resort.

As mentioned in the testimony, we suggest that the most obvious and effective way to alleviate this potential conflict of interest would be to rescind the new lending authority.

5. In connection with Sallie Mae's sole authority to consolidate, do you believe sole authority should be removed from law, and state agencies given the option to consolidate?

How would giving state agencies the option to consolidate help keep down default rates, and how would it save the government money?

We believe that no lender, public or private, or secondary market should be prevented from consolidating students' loans. Consolidation works to the advantage of both students and lenders and should be encouraged.

While prudent consolidation procedures may well help to reduce defaults by lowering some students' net monthly repayment burden, it is not likely that consolidation will save much money. Rather, it should be done because of the positive impact it would have on students and lenders.

6. Sallie Mae recently sought the concurrence of the Secretary of Education in its view that Sec. 438(b) (2) (B) (i) of the Act

does not preclude the special allowance to states on GSL loans made by those states with proceeds of advances from Sallie Mae. The secretary, by his letter dated June 7, 1982 to Mr. Ed Fox, did not concur with their view.

What is the state agency position on this question, and how would it affect state agencies if the secretary, or the Congress, does concur with Sallie Mae's view?

We do not have a strong opinion on this issue, nor as a direct lender do we have particular expertise in this area. We suggest you rely on the advice and judgment of our colleagues who operate guarantee agencies.

7. Sallie Mae probably will seek authority to lend directly to colleges enabling them to make uninsured loans, through local banks.

What is your position on such proposals. If you agree, who should set the terms for such loans, and how high an interest rate should be required of students obtaining such loans?

As alluded to in our response to question 3, our major concern with Sallie Mae becoming involved in holding unsecured loans would be that these loans could increase the corporation's costs of serving traditional lenders with guaranteed loans. One simple solution would be to insist that Sallie Mae segregate its guaranteed and unsecured activities.

As also mentioned in question 3, we remain skeptical of the financial viability of providing unsecured loans. We would assume that the terms and interest rates on such loans would have to be sufficient to cover the cost of defaults and loan administration. As a result, the rates on such loans would probably not differ much from conventional consumer loans.

8. It is the expressed opinion of Sallie Mae that the $5 billion they have borrowed (as of January 1982) from the federal financing bank does not constitute and cannot be called "federal funding", "taxpayer dollars", or "federal contributions" for Sallie Mae's purposes. Do you agree?

Sallie Mae continues to receive two financial benefits from public sources: (1) an exemption from state and local income taxes; and (2) outstanding commitments of $5 billion to the federal financing bank, which will last for at least another 15 years.

It is absurd for Sallie Mae to deny that these provisions don't provide financial benefit to the corporation, at the expense, albeit indirect, to both state, local, and federal government, or to assert that these provisions don't provide them with a competitive advantage over other for-profit corporations.

9. Do you believe the temporary exemption from federal priority

under bankruptcy statutes for Sallie Mae now in effect, but due to expire September 30, should be made permanent?

If such exemption is extended, would it be better to limit it to no more than two additional years, and then conduct oversight hearings again on the issue?

We recognize the difficulty Sallie Mae would currently have borrowing in private capital markets without the bankruptcy exemption. Therefore, we support the recent extension, but would recommend that this provision be reviewed periodically and that it be eliminated when Sallie Mae has become an established borrower in private capital markets.

10. Sallie Mae pays no state or local taxes. Should Sallie Mae be required to pay at least local taxes in the District of Columbia on its transactions/profits?

Should Sallie Mae be required to pay state taxes on profits made in the states where it provides liquidity, etc?

If Sallie Mae is truly a private, for-profit corporation, it is not clear why it should not be subject to the same tax laws that apply to other for-profit corporations. Obviously, Sallie Mae's profit margin would be reduced if it paid taxes and as a result the corporation's clients (such as ourselves) would no doubt have to pay more for the services we receive.

One could argue for maintaining its tax exempt status if Sallie Mae were serving a uniquely public purpose and were being held fully accountable to serve that public purpose.

I hope these comments are responsive to your questions. Please let us know if we can be of further assistance.

Sincerely,

David A. Longanecker

DAVID A. LONGANECKER
Deputy Executive Director

DAL::lw

QUESTIONS FOR MESSRS.

HAWK, LONGANECKER, BORDEN, AND IVERSON

1. What impact upon the delivery of student loans would you foresee if Sallie Mae were made a fully private actor in the marketplace, e.g. by the enactment of legislation empowering other financial institutions to do the same things that Sallie Mae does in as many areas as possible, and removing from her any power or status which could not be opened up in this way (preserving, however, rights and duties concerning business originated under the current set-up)?

2. What structural changes in Sallie Mae would you advocate to better resolve the inherent tension between the Congressional motive of employing Sallie Mae simply as a tool for serving the paramount interest of students and Sallie Mae's overriding profit motive, which may serve that student interest to a greater or lesser degree depending on the factual context of any given decision or policy?

Question #1

The enactment of legislation empowering other financial institutions to perform services currently performed by Sallie Mae should improve the delivery of student loans. First, Sallie Mae would be placed in a position of increased competitiveness with financial entities desiring to participate in student loans. This increased competitiveness should lead to many of the benefits commonly found in a normal business environment such as simplicity of operation, the lowest possible cost of services provided, improved delivery of services, and greater speed in negotiating financial agreements. Such action should also result in innovations in administering the various loan programs. It would allow entities at the state level to tailor programs to serve their individual needs with Sallie Mae continuing to play a prominent national role. One of the key problems with Sallie Mae at the current time is that it is a monopoly. Many of the problems outlined in testimonies before this committee on August 12, 1982, were problems brought about by this monopoly power. In summary, remove the monopoly that Sallie Mae currently enjoys and competitors will cause many of the problems to disappear.

Question #2

As I understand it, the original congressional intent for Sallie Mae was to increase the liquidity of guaranteed student loans and thereby increase the availability of GSLs. Through numerous amendments, Sallie Mae has been allowed to stray from this original intent. It would be my suggestion that legislation be enacted to revert Sallie Mae to the original congressional intent. I would suggest that their power to make direct loans be rescinded; that their power to consolidate loans be rescinded and that power be provided to state agencies. I would suggest that Sallie Mae be allowed to purchase consolidated loans after such consolidation had taken place under state administered programs. In addition, Sallie Mae should be reestablished as a governmentally chartered, non-profit corporation and be forced to operate as other such corporations. In summary, their motive for making a profit should be removed so that the organization can better focus upon the original congressional intent of providing liquidity for the guaranteed student loan program as their sole reason for existing.

RESPONSE TO SENATOR HATCH'S QUESTIONS

Question #1

What impact upon the delivery of student loans would you foresee if Sallie Mae were made a fully private actor in the marketplace, e.g. by the enactment of legislation empowering other financial institutions to do the same things that Sallie Mae does in as many areas as possible, and removing from her any power or status which could not be opened up in this way (preserving, however, rights and duties concerning business originated under the current set-up)?

Response to Question #1

It is quite possible that the potential risks associated with creating making Sallie Mae fully private may outweigh the costs of maintaining some clearly established public purpose for the corporation.

The major potential advantage of making Sallie Mae fully private, with equivalent "power or status" to any other "private actor in the marketplace," would be the obvious benefits accrued from market competition. First, the greater competitiveness might enhance Sallie Mae's responsiveness to clients, with a requisite increase in the level of services provided. Likewise, in certain areas such as the consolidation of loans student borrowers would be better serviced by the availability of a variety of options rather than through the single consolidation option now allowed Sallie Mae.

But other factors would make it quite possible that making Sallie Mae wholly equal to private financial institutions might seriously impair effective operation of the overall Guaranteed Student Loan (GSL) Program. Many of Sallie Mae's current clients are the same entities with which she would be competing. Such competition would very likely erode the symbiotic relationships that currently exist between public and private lenders and Sallie Mae as a secondary market. For example, Sallie Mae could improve its overall competitive position by reducing its traditional areas of service to both private and public lenders. It is even possible that Sallie Mae might abandon its role as a secondary market, if it were able to operate more lucratively as a lender than it does as a secondary market. Private lenders have always shown reluctance to provide secondary market services--indeed that is why Sallie Mae was created--and Sallie Mae might show similar reluctancy if it can use its limited resources in more productive ways.

Question #2

What structural changes in Sallie Mae would you advocate to better resolve the inherent tension between the Congressional motive of employing Sallie Mae simply as a tool for serving the paramount interest of students and Sallie Mae's overriding profit motive, which may serve that student interest to a greater or lesser degree depending on the factual context of any given decision or policy?

Response to Question #2

We suggested in our testimony that Congress rescind those authorities that create the inherent conflict-of-interest for Sallie Mae. Unless it is the federal intention to promote a privately controlled national student loan bank, there is no reason why Sallie Mae should have the protected privilege to operate

both as a secondary market and as a lender, with the sole ability to consolidate loans.

We also suggested in the testimony that the Congress should establish a regular procedure for overseeing Sallie Mae's operations and activities. Indeed, these hearings have demonstrated how useful such oversight can be, both in better understanding Sallie Mae and in holding the corporation accountable for its actions.

Senator STAFFORD. Thank you very much, Mr. Longanecker.

Mr. Borden, we would be glad to hear from you.

Mr. BORDEN. Thank you very much, Mr. Chairman. I shall attempt to be very brief and to touch primarily upon points which have not yet been discussed before the committee. I do appreciate the time you and your staff are spending to conduct these oversight hearings and believe that they are important to the continued viability of this extremely important higher education program.

In order to place some of my remarks in context, I should perhaps inform you that I speak for two organizations in Kentucky. I am executive director of the higher education assistance authority, which is the guarantor in the State, and also, as a matter of statute, serve as executive director of the higher education student loan corporation, which provides a secondary market and a direct lending service for the commonwealth.

Both of these activities are relatively new in the Commonwealth of Kentucky. We began the secondary market program with a financing in March 1979 which included a $30 million put option executed with Sallie Mae. So, our experience with them goes back to that date.

Between that financing and a subsequent financing which was completed in July 1981, we negotiated two master note financings with local lending institutions in the State—one for $10 million and one for $30 million.

In July 1981, we completed a new revenue bond financing, again with participation by Sallie Mae, with a put option in the amount of $130 million. Essentially, what that agreement did was allow us at some date in the future, prior to mid-1984, under certain conditions, to sell to Sallie Mae that $130 million in principal amount of loans.

Since that negotiation, within the past month we have again gone back to the commercial lending resources and have negotiated $100 million in master note agreements to finance this fall's activities.

So, our activities in financing of the student loan program have involved Sallie Mae and alternative financing. I can tell you without any equivocation that we have found that it is much easier and, in many cases, much less expensive to finance through commercial lending entities than it is to finance through Sallie Mae.

As an example of that, this is a Sallie Mae agreement, to give you some indication of the complexity of the agreement [indicating]. The master note agreement which we negotiated with the banks in Kentucky was about this thick [indicating]; this is probably a little bit thicker than that agreement. That negotiation took about 30 days; the ones with Sallie Mae take about 6 months.

Now, let me talk about one particular concern that we have in Kentucky related to the options program—the loan consolidation program—administered by Sallie Mae. We are very much concerned as to their capability to, in effect, cream the portfolio which we have financed in Kentucky by consolidating out those loans which have high-principal balances which support the low-principal balance loans in the portfolio.

Additionally, we are concerned and think you ought to be concerned that that program, in effect, converts an uninsured, unsub-

sidized loan—national direct student loans—to insured, fully subsidized loans with extended pay-outs, so that the long-term cost of those consolidations may indeed be very great for the Government.

We do not at this point in time, under the structure presently used by Sallie Mae, see equivalent benefits flowing to the students.

I would also point out to you that as a revenue bond financed secondary market in Kentucky, any time a loan is consolidated out of our portfolio into the Sallie Mae portfolio, the special allowance payments will, in most cases, double because we do have that 50-percent reduction of SAP payments.

In effect, if we exercised our 130 million put option with Sallie Mae, you would see a very significant increase in the cost to the Federal Government of that particular exercise of our authority.

Another point with respect to the program is that I think the monopoly status granted to Sallie Mae to administer loan consolidations has stifled innovation in that arena, and has kept our program, and I am sure many other State programs, from developing consolidation activities which could provide greatly increased benefits to our students.

Finally, in looking at the parameters for the options program, it seems to me that they have failed to adhere to what I understood to be the congressional intent to reduce defaults. For example, the requirement that the loan be current—and my understanding is that the three initial payments be made in advance of consolidation—certainly eliminates many predefault loans.

A couple of general concerns with respect to the agreements we have negotiated with Sallie Mae: Over the past several months, we have looked at their fee structure for both commitments and their termination terms. We do not find those to be competitive.

We are concerned about negotiation tactics engaged in by Sallie Mae where they send staff to negotiate agreements that do not have the necessary authority to bind the corporation, and in many cases not to even indicate the exact position of the corporation.

We are concerned about the extreme complexity. We are concerned about serial loan requirements, under which, if we ever put loans to them under one of these agreements, they would be able to call at their option subsequent loans out of the portfolio in Kentucky, which would perhaps make future financings improbable, if not impossible.

What are some of the solutions? It seems to me that some of the more recent amendments have digressed substantially from the plan which was laid out for Sallie Mae in 1972. I think we should strip them of some of the unused authority. The uninsured loan program may dilute the asset base for the insured loan program.

The direct lending capability is a continuing, ever-present threat to any direct lending program operating in the State. Some of their publications indicate a capability to underwrite revenue bonds. To the extent they choose to exercise that capability, it gives them an enormous amount of influence over the market, under which they could demand to be a comanager on an issue and to share in the fees associated with it.

I do believe the bankruptcy provisions should be extended. I think the $5 billion in assets guaranteed must be available to sup-

port their borrowings and the other part of the market. I believe the consolidation program should be extended to State agencies.

I believe you should consider reducing the term of the FFB financings to match the maturity of the Sallie Mae-acquired obligations. And, I think you ought to consider that the Sallie Mae exemption from State, municipal, and local taxation may, in fact, be draining revenue out of some of the State coffers. And, we do indeed need that revenue at this point in time in the States.

So, while we may have Federal and State tax exemption, I would note to you that, indeed, Sallie Mae does have preferential borrowing from the Federal Financing Bank, and they do enjoy State, municipal and local taxation exemptions.

I appreciate this opportunity. Thank you very much.

Senator STAFFORD. Thank you very much, Mr. Borden.

Mr. Iverson, if you could stand by for just a minute, the Chair is going to have to recess the hearing very briefly.

[Whereupon, a brief recess was taken.]

Senator STAFFORD. We will resume the hearings.

We were at the point of asking Ron Iverson to speak to us. Ron, we are ready to hear you.

Mr. IVERSON. Thank you, Senator. It certainly is a pleasure to be before your committee today. I will try to keep my remarks as brief as possible, and say that my friend and colleague from Kentucky, even though he is a little further south than Vermont, certainly does share and express our views regarding secondary markets.

As you know, Senator, Vermont has an organization which is a public corporation that is responsible for grants, scholarships, counseling services, secondary market and guaranteed loans. We do have 100 percent lender participation in our guaranteed loan program. Higher education is the third largest employer in our State.

What I would like to do is to share with you today our experiences with secondary markets, and then offer some observations and recommendations.

Being a small State, we have small-asset banks. We also have one of the largest grant programs in the country on a per capita basis. Our student indebtedness in many cases is not that large. When our banks first discussed liquidity in a secondary market, we discussed with them direct sales to Sallie Mae. There were many reasons that that was rejected.

One, you have heard Sallie Mae's requirements to purchase large outstanding debt from students. Also, at that time our lenders had been involved in the Federal insured loan program and they still recalled the problems dealing with a Washington agency or a central agency.

Our views and concerns dealt around two areas. First, we were very concerned over what would happen to our excellent repayment rate. You know, if I as a student did not have a loan payment in on time—my dad could be walking down the street in Saint Johnsbury, and—I could be in Turkey. Joe Sherman from the Citizens Savings would have tapped him on the shoulder and said, "Phil, Where is your son, Ron? I am missing $39.25," and I would have heard about it. That type of activity allows Vermont to maintain a GSL program where 98.5 percent of the students are meeting their loan obligations.

We were very concerned about what would happen if an outside servicer took over our portfolios. In fact, recently we asked Sallie Mae to provide us information regarding their default rates, and we have not heard at this time. I am hoping we will in the future.

Being very honest with the committee, Senator, I must say we also looked at the profits Sallie Mae was making in secondary markets, and concluded that if such profits existed, our agency should operate the program, obtain those revenues, and use them to improve student financial aid program services for the people of Vermont, and use those surpluses to purchase more loans and maintain an excellent stipend loan administration.

I think this does show the difference between a State, public, nonprofit group administering a secondary loan market and that of a profitmaking corporation, where the latter represents stockholder concern.

After this decision was made, we began to look at structuring our own financing. Recently, at the end of June, we invited Sallie Mae to participate in the financing hearings in order to help strengthen the financings with a put- or take-out type of option, along with other lenders.

I am deeply concerned over the requirements and conditions Sallie Mae required for their participation, and would refer to some of the comments Mr. Longanecker made. I am in the process of writing to Ed Fox to express our concerns on a number of specific points, as I do not feel the financing would be feasible with Sallie Mae under their proposed agreement. And I would be happy to submit a copy of that letter to you for the record.

Senator STAFFORD. Without objection, we will put it in the record.

[Information submitted for the record follows:]

VERMONT
STUDENT ASSISTANCE CORPORATION

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Ronald J. Iverson

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Chairman
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Phyllis Johnson
H. Donn McCafferty
James M. Pollock
Hilton A. Wick

September 30, 1982

The Honorable Robert T. Stafford
United States Senate
5219 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Stafford:

During your hearings on activities of Sallie Mae, you requested I include as part of my testimony a copy of the letter I was sending to Sallie Mae expressing concerns regarding their participation in our secondary loan market financing. I am happy to enclose a copy of that letter for the official record.

In addition, I am enclosing for the record my response to Senator Randolph's written questions.

Best wishes,

Ronald J. Iverson
Executive Director

Enclosures

RJI/bp

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Hilton A. Wick

September 29, 1982

Mr. Edward A. Fox
Student Loan Marketing Association
1050 Thomas Jefferson Street, N.W.
Washington, D.C. 20007

Dear Ed:

The Vermont Student Assistance Corporation is preparing to sell its initial bond issue in the amount of approximately $75 to $100 million in the spring of 1983. The Corporation is anticipating a need to structure a three to five year issue backed by a credit facility from a major financial institution. Representatives from Sallie Mae presented the seller/servicing product to the Corporation for its consideration as the back-up credit facility. Although the basic concept is an attractive one, the Corporation would find it most difficult to enter into the seller/servicing commitment with Sallie Mae at the present time for two central reasons:

1. The representatives of Sallie Mae with whom the Corporation has direct contact do not have the authority to negotiate terms with the Corporation. Other financial institutions with which the Corporation might deal are structured such that the authority for negotiation is vested in the people who attend the document sessions. In order for Sallie Mae to offer its services on a timely basis and to participate on an equal basis with all other parties to the transaction, the Corporation would contractually require the presence at all negotiating sessions of decision makers accompanied by legal counsel responsible for developing documents. Without such arrangements, Sallie Mae's internal procedures could delay our timetable significantly. In the experience of other issuers, these delays have been in some cases more than six months.

2. The terms of the seller/servicing agreement are not competitive with terms offered by other financial institutions. The commitment fee the Corporation

would pay to Sallie Mae and the servicing fees Sallie Mae would pay to the Corporation do not, in general, reflect market conditions. Other terms unique to Sallie Mae, such as the servicing escrow, seriously affect the feasibility of a bond issue and are not requirements of competing financial institutions. Attached is an identification of and comment on some of the salient Sallie Mae terms and our suggestions for adaptations which would more closely align Sallie Mae's terms with terms which are acceptable to the Corporation and which are currently available from other financial institutions.

After reviewing the attached comments, you will note that the conditions imposed by Sallie Mae affect substantially the feasibility of the Corporation's planned financing program, and would in fact require additional fees and requirements equal to $1,950,572 on a present value basis at the time of the financing.

The Vermont Student Assistance Corporation is anxious to work with Sallie Mae to address these problems, as we believe it is in both our interests to develop a constructive working relationship.

We would like to explore this matter further with you, and look forward to hearing from you.

Sincerely,

Ronald J. Iverson
Executive Director

Attachment

RJI/bp

Vermont Student Assistance Corporation
Review and Comment
on
Sallie Mae Seller/Servicing Forward
Purchase Commitment Terms and Conditions

Below we have reviewed several of the conditions and terms identified in the Sallie Mae "Standard Public Sector Terms-Seller/Servicing Program." While it is the Corporation's strong feeling that these changes to Sallie Mae's terms are required in order to make its program competitive with other providers of student loan takeout arrangements and to make bond financing with a Sallie Mae agreement financially feasible, the Corporation remains willing to engage in good faith negotiations in order to develop a mutually satisfactory arrangement.

Purchase Price

Sallie Mae would pay to the Corporation the par value of the loan portfolio with no consideration for accrued interest or special allowance payments. Although the Corporation may bill the Federal government for the special allowance and interest payments owed to the Corporation for the period it held the loans prior to their sale to Sallie Mae, it may not do so until the end of the quarter. Because the Department of Education payments for interest on loans during the interim period and for all special allowance payments are generally received by the Corporation one month following the end of the Federal fiscal quarter, on any date accrued interest and special allowance payments will always exist. To ignore this and insist upon a purchase of the loans at par with no consideration of accrued interest is a significant detriment to program feasibility. Since all other prominent takeout arrangements are inclusive of accrued interest, this term seems particularly onerous. We recommend, therefore, that the commitment amount remain the principal amount of the loans but that the purchase price include accrued special allowance and interest payments for the period in which the loans were held by the Corporation. For purposes of determining the accrued special allowance, the assumed rate would be the minimum rate applicable to each type of loan in the portfolio purchased by Sallie Mae. When the special allowance payment is received by the Corporation from the Federal government, the minimum rate would be remitted to Sallie Mae, and the Corporation would keep the balance, if any.

Early Termination and Partial Reduction of Commitment

The requirements relating to cancellation of partial reduction of the commitment amount are wholly inconsistent with terms available in other takeout arrangements and significantly detract from the credit worthiness and program feasibility of any bond financing program. Virtually all other takeout arrangements provide for early cancellation or reduction of the commitment amount under essentially any circumstances with no penalty. The Sallie Mae terms, which permit no reduction or termination under any circumstances for one year, and which severely penalize the Corporation for any later termination or reduction by requiring it to pay all of the future fees at the time of the reduction, are very disadvantageous for two reasons. First, in the event that due to program changes, dramatic shifts in demand, or other drastic circumstances, the Corporation was unable to originate any eligible loans,

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the Corporation must be able to demonstrate to the rating services that the issue is structured in a manner which will enable the issuer to redeem the bonds without defaulting on any interest or principal. If the seller is unable to terminate the commitment, or if it is only able to do so at a severe penalty, the rating services would seriously question the credit worthiness of the financing structure. Second, in any student loan takeout financing, the issuers are issuing short-term bonds with a best efforts requirement to issue long-term obligations to refund the original bonds. Since this requirement may dictate that the issuer refund the original bonds at any time prior to their maturity, the early termination penalties significantly decrease the feasibility of any refunding. We therefore recommend that the terms of the Seller/Servicing agreement permit early reduction or termination at any time without penalty.

Escrow Fund

The escrow fund requirement is also a disadvantageous term for the seller in the Sallie Mae proposal. The effect on the bond financing feasibility is substantial. Since Sallie Mae requires that the escrow fund interest earnings be retained in the fund and since neither the earnings nor the initial deposit to the fund may be considered an asset of the bond issue, the escrow fund represents an up-front reduction in the earning assets received at bond delivery. This is, in effect, similar to paying additional costs of issuance, since the cost of the escrow fund must be recovered from the earnings of the remaining assets. In a typical financing of a $100 million loan portfolio, it would effectively increase the cost of the program by .37 percent (see the attached appendix). In the current market, both high tax-exempt interest rates and the historically high ratio of tax-exempt to taxable yields makes the escrow fund in many cases the difference between program feasibility and lack of feasibility. We recommend that the escrow fund requirement be eliminated.

Serial Call

The serial call option is also not required in other takeout arrangements. While there are several advantages to both the Corporation and Sallie Mae from this requirement, there are also potential disadvantages in this arrangement which Sallie Mae should recognize. Under the serial call provision, the Corporation may be forced to sell to Sallie Mae, at any time in the future, any loans the Corporation holds by borrowers who also have loans held by Sallie Mae. This provision allows Sallie Mae to select only the best loans for its portfolio and virtually requires the Corporation to continue future business arrangements with Sallie Mae regardless of the existing conditions. We recommend that this requirement permit some degree of flexibility on the part of the Corporation.

Ability to Sell Loans to Other Parties

The commitment agreement should be a specific obligation to sell loans to Sallie Mae at an agreed upon point in the future. Circumstances may arise in which it would be in the Corporation's interest to undertake an independent sale of loans to another party during the commitment period without affecting its ability to sell the loans to Sallie Mae specified in the commitment agreement. It is therefore an unreasonable burden on the Corporation's flexibility to prohibit sales to any other party during the commitment period. This provision, particularly when combined with the serial call provision, is effectively a restraint on trade and insures that Sallie Mae does not have to remain competitive with other institutions.

Notification of Purchase Obligation

Sallie Mae requires that notification of purchase be made 180 days prior to the commitment date. All other takeout arrangements require 90 days or less. This six-month period is likely to be a time when any refunding bonds would be issued, and, hence, the additional three-month period imposed by Sallie Mae seems excessive. We recommend a 90-day notification period consistent with other arrangements.

Loan Documentation

In general, the loan documentation and technical requirements of the Sallie Mae commitment agreement are much more restrictive than any other takeout arrangement, although much of this is understandable given the different nature of the seller/servicing agreement. We feel strongly, however, that several of these requirements should be the basis of good faith negotiations between the Corporation and Sallie Mae, rather than inflexible terms. In addition, the agreement requires that the Corporation make, in effect, a general obligation pledge as to the compliance of each loan to Sallie Mae's requirements regardless of the good faith effort made by the Corporation in its servicing and origination. This obligation should be limited through a safe harbor which protects the Corporation in the event of fraud or other circumstances.

Servicing Performance Standards

Although the Corporation understands the importance to Sallie Mae of maintaining consistent performance among its servicers, the level of detail identified in the terms of the agreement imposes an onerous technical burden without a safe harbor for the Corporation. In general, the Corporation should be evaluated in terms of the results of its servicing performance in aggregate. The specific method for evaluation of the servicing should be subject to negotiation.

Commitment Fee

The 3/8 of one percent annual commitment fee quoted by Sallie Mae is fifty percent higher than the 1/4 of one percent annual fee quoted by at least three other student loan takeout providers. Since the quality of the credit offered in each of these arrangements is similar and since the Sallie Mae agreement, as noted above, requires significantly more accomodations on the part of the issuer, the higher fees are clearly not warranted.

Servicing Fee

The servicing fee quoted to the Corporation under the seller/servicing agreement would be 1.25 percent of the outstanding portfolio. National servicing organizations generally charge 1.5 to 2.0 percent of the outstanding portfolio. Under the seller/servicing agreement, therefore, the Corporation would be losing money by subcontracting the servicing. We recommend that these fees be subject to negotiation.

Late Payments by Federal Government

The servicing contract specifies late charges to be paid to the Corporation in the event interest and special allowance payments are received by Sallie Mae after the 31st day of the month in which they are due to be paid by the Federal government. This provides no safe harbor to the Corporation if for some reason the Federal government is late in its payments. There is no reason for the Corporation to fully bear this risk. We recommend that payments to Sallie Mae from the Corporation be required only after their receipt by the Corporation from the Federal government. To the extent, however, that penalty payments are received by the Corporation from the Federal government, they would be forwarded to Sallie Mae.

Late Payments by Students

As with the Federal payments, the servicing contract specifies late charges to be paid to Sallie Mae by the Corporation in the event students are late in making monthly payments to the Corporation. In addition to the obvious potential financial disadvantage of this arrangement, the Corporation may potentially be legally barred from entering such an agreement since it effectively requires the Corporation to act as a guarantor to Sallie Mae for the entire loan portfolio. This is not required in other servicing contracts. We recommend that these payment deadlines be subject to negotiation and contain a safe harbor for the Corporation in forwarding late payments without penalty under certain circumstances.

Appendix

Assumptions Employed in Determining
the Effect of the Sallie Mae Terms

In the assertions as to the financial effect of some of the Sallie Mae terms discussed in the attachment, the Corporation has assumed a typical three-year bond issue with the following general components:

Amount of Portfolio	$100,000,000
Escrow Fund	1,000,000
First-Year Commitment Fee	375,000
Reserve Fund (six months' interest)	5,446,500
Cost of Issuance	200,000
Underwriters' Discount (1.75%)	1,906,275
Rounding	2,225
Principal Amount of Bond Issue	$108,930,000

We also assumed that the dated date (the date on which interest on the bonds begins accruing) and the delivery date (the date on which the Corporation would receive payment for the bonds) were the same and were three years prior to the maturity date. The interest rate on the bonds was assumed to be 10 percent.

The higher costs imposed by the Sallie Mae terms may only be recovered by the Corporation through earning a higher rate of return on its borrowed assets (the bond proceeds which the Corporation may lend or invest). For example, if the Corporation received the full $108,930,000 in cash above and invested it, the Corporation would have the amount of money required to pay semi-annual debt service on the bonds and the principal at maturity if it invested the money at 10 percent. However, since the Corporation must pay certain costs to sell the bond issue and to run its program it must invest its remaining assets at a rate higher than 10 percent. Thus, the Corporation would pay certain of its own costs of issuing the bonds which are then reimbursed from bond proceeds. If we remove this $200,000 from the assets at the time of bond delivery, the remaining assets must earn a higher rate of return in order to have sufficient funds to pay debt service on the bonds, or 10.0724 percent. The effect of the costs of issuance on financial feasibility, therefore, is .0724 percent. When the underwriters' discount is paid, the earning assets are reduced further by $1,906,275. The effect of the discount on the feasibility is thus .6973 percent. Together these two costs total .7697 percent, so the effective interest cost on the bond issue is 10.7697 percent rather than the 10 percent coupon rate. This is the "cost of money" to the Corporation.

In order to assess the effect of the Sallie Mae fees and provisions on financial feasibility, the present value of these fees was determined using a discount rate of 10.7697, or the cost of money to the Corporation identified above. The discount rate is a method of determining the value of a future payment today, assuming that it could be invested at that rate until the payment is actually made.

The accrued interest and special allowance on the student loans would not be paid by Sallie Mae on the date of the bond maturity. If we assume that the portfolio is composed equally of "new" 7 and 9 percent loans, and that the interest and special allowance payments have accrued for one month, then the shortfall would be $791,667, if the special allowance payments are the minimum of 2.5 and .5 percent for the respective categories of loans. The present value of this amount is $577,927, and the effect on feasibility is therefore .21 percent.

The commitment fees paid to other financial institutions is .25 percent, while Sallie Mae charges .375 percent. The difference is $125,000 annually in this scenario, the present value of which is $338,896. The effect on feasibility is .123 percent.

The escrow fund required by Sallie Mae is equivalent to an immediate reduction in assets, since no income may be retained by the Corporation and since the principal of the fund may not be used to pay the bonds at maturity. The effect on bond feasibility is .367 percent.

The total present value of the costs of which must be paid to Sallie Mae (including the escrow fund) is $1,950,572, with an effect on feasibility totalling .714 percent. Note that these are just the fees that are unique to Sallie Mae and are in addition to those which must be paid to Sallie Mae but which are consistent with commitment agreements offered by other institutions.

Mr. IVERSON. Not to bore you, but just let me give you two examples. The Department of Education payments for interest are on a quarterly basis, and interest is usually received 1 month following the end of any fiscal quarter. Therefore, at any date there are accrued interest payments.

When Sallie Mae purchases our loans at par, they ignore the interest that is accrued while we own those loans during the quarter and will not pay that to us. That does not sound like much, but on a $50 million purchase, Vermont would make a donation of $2 million to Sallie Mae in interest on loans that we owned at the time if it went the full quarter.

Sallie Mae's commitment fee was quoted to us at a 50-percent higher rate than other private financial institutions quoted to us—again, millions of dollars that we could not afford.

Turning to some observations and recommendations, being a neophyte, I have heard a lot of rumors—I do not know whether they are true or not—regarding secondary markets, not only including Sallie Mae rumors but many others. To eliminate such rumors, and since Sallie Mae is a publicly created entity, I would recommend that Sallie Mae's laws be changed so they also come under the Freedom of Information Act, open meeting laws, et cetera—similar to the right to know laws, in Vermont.

Thus far, we have been able to obtain, overall, better terms from private banks, which does surprise me because they have not had the benefits of Federal subsidies and access to the Federal Financing Bank. Perhaps Congress should review what are appropriate profit margins for Sallie Mae and any other secondary market. I think Senator Randolph's comments regarding GAO audit could address that point.

In the area of Sallie Mae's Options program, I think as more emphasis is placed on student loans in the future, it is essential that students have a longer repayment opportunity. I do agree with Mr. Borden and others that we should not charge students more interest to consolidate loans, and support Sallie Mae's suggestion to charge actual interest.

In order for us to continue offering programs that best meet the needs of Vermonters, I would recommend that in any legislation this committee passes, it would also include provisions allowing nonprofit secondary markets to consolidate student loans, as Sallie Mae. I think this is probably one of the most important things to Vermont at this time.

I would second the taxation idea mentioned by Mr. Borden; that a profitmaking, stockholding company should not be exempt from State taxes, particularly in a period when Federal expenditures are being scrutinized and revenues on both the State and Federal level are scarce.

Possibly, the Federal Government should consider asking Sallie Mae to refinance part of its Federal financing debt in the private market. Just some quick calculations on that: I calculated that that is, if you look at Sallie Mae's spread of return on a guaranteed student loan to their cost of money at the FFB on $5 billion, that is close to $169 million they earn in direct subsidy.

Another area where we could help reduce the Federal budget expenditures is in the area of the special allowance payments. When

nonprofit secondary markets purchase student loans, the amount of the special allowance payment is cut in half. I would do everything you could to encourage more States to take this opportunity.

I believe that the question Senator Randolph asked Mr. Fox regarding the recent Federal funds in private corporations does exist. Sallie Mae receives reinsurance for bad debts; those are Federal funds. And when the bankruptcy provisions are changed, it also puts $5 billion of taxpayers' money in more jeopardy for charge-off in bankruptcy. So, there are Federal subsidies involved with Sallie Mae.

Overall, perhaps the committee should consider whether Sallie Mae is really a private entity, and make it that way, or truly a public entity, and make it that way.

I have appreciated the opportunity to be here today, and hope that the committee will continue to take an active interest in the appropriate role and performance of Sallie Mae. Thank you.

Senator STAFFORD. Thank you very much, Mr. Iverson. The Chair has three questions which we would ask any of you who wish on the panel to respond to, again bearing in mind that brevity is sometimes the soul of wit.

Let me start with this one. What would you describe as Sallie Mae's responsibilities? Does anybody care to take a shot at that? Mr. Longanecker?

Mr. LONGANECKER. Let me take a brief shot myself. I think Sallie Mae has two primary roles. One is to make a profit; it was clearly set up to make a profit. I do not think that is a bad goal. I think it helps them operate in a very business-like fashion.

The other principal goal, I believe, is to offer a secondary market. Our major complaint is that now those responsibilities have been expanded to the point where it has conflicting goals between being a secondary market and a lender or a guarantor or an underwriter.

Senator STAFFORD. Is there any disagreement with that? Mr. Borden?

Mr. BORDEN. No. I would tend to reinforce that by saying that I think even Sallie Mae understood its role much, much better prior to the last two sets of amendments. I think the extraordinary grants of authority given to them in the last go-around made it difficult for them to know what their primary function is at this point. Certainly, for us it is difficult.

Senator STAFFORD. Thank you. Are there any performance objectives by which we might measure Sallie Mae from a public policy perspective?

Mr. LONGANECKER. Yes.

Senator STAFFORD. Mr. Longanecker?

Mr. LONGANECKER. Just as an example, I think one way you could look at how Sallie Mae is performing is to look at whom it is serving geographically and by type of lender. There was much mention made that its board is a representative group of users and concerned citizens. I do not believe there is strong representation, at least, from the tax-exempt lender community on Sallie Mae's board.

I think another way you could do it is to look at the comparison between its profit and the cost of services that it is providing, or

the cost that it is charging for services to its clients. I think you could also look at the comparison of what Sallie Mae is offering compared to what regular, private lending institutions are offering for terms. I think those are examples of up performance objectives for Sallie Mae.

Senator STAFFORD. Thank you. Mr. Borden?

Mr. BORDEN. I would suggest you ought to solicit from State agencies and/or from Sallie Mae copies of various financing agreements which it has entered into with State secondary markets, and examine those in contrast to some of the financings that have been entered into with commercial entities.

Mr. IVERSON. I would add to that, Senator. In Vermont, the way you make profits is to keep your expenses down. Sallie Mae is working on a very small percentage of profit. I think the way to review its performance would be to review its expenses and the type of expenses it incurs and for what purpose and compare that to other agencies.

Senator STAFFORD. Thank you all. One final question: Has Sallie Mae indicated to any of you that it intends to pursue its authority to act as a direct lender?

Mr. HAWK. It has not to me, Mr. Chairman.

Senator STAFFORD. I notice, Mr. Longanecker, that you are shaking your head negatively.

Mr. LONGANECKER. No, it has not. In fact, I think they have explicitly stated the opposite at this point. I think our concern is not with the current leadership of Sallie Mae. It is with the conflict of interest that exists in their prerogatives and authorities.

Senator STAFFORD. Thank you. Is there any different response from Mr. Borden or Mr. Iverson? If we hear none, we will assume you all agree that you have not been informed.

[No response.]

Senator STAFFORD. All right. Gentlemen, on behalf of the committee, I wish to express our deep appreciation to you for helping us this morning and remind you that the right to submit questions in writing has been reserved to members who were not able to be here this morning and for those who were here and had to leave. If that is agreeable, we would appreciate your responses at your early convenience. Thank you very much.

[The following was supplied for the record:]

IVERSON RESPONSES TO SENATOR RANDOLPH QUESTIONS

1. **Should the subcommittee, in developing any legislation to address concerns of today's hearing (if any), consider requiring Sallie Mae to retire all government guaranteed notes before they retire new notes they are now selling to the public?**

If you think so, please explain why?

In general, we believe that Sallie Mae should issue debt backed by its own credit.

In May 1981, Sallie Mae began borrowing in open markets without Federal guarantees through its discount note and floating rate note programs. Each of these financings is essentially self-supporting.

While we would strongly discourage further Federal borrowing subsidies or guarantees, it would appear necessary for Congress to establish some sort of accelerated repayment of Sallie Mae's debt to the United States, particularly since they continue to enjoy the same rate of return on their student loans as a commercial/private lender; even though their (SLMA) cost of funds was less than the commercial lender. It should also be remembered that states in their secondary markets and hopefully loan consolidation programs only receive half of what Sallie Mae receives in Federal SAP interest payments thus reducing the cost of the GSLP Program to the Federal government.

2. **Sallie Mae's new authority under (d) (1) (D) (Reconciliation) to undertake any other activity it determines to be in furtherance of the GSL program, or otherwise support the credit needs of students, has been criticized as too open-ended and thus poses a threat to state agencies.**

Should we amend that section to include either a one-house veto authority over any implementation of this provision, or require Sallie Mae to wait 45 days before implementing any of its new authority under that subsection?

Any other suggestions?

It is the task of state agencies to undertake activities which in some way provide capital to students at an acceptable cost. With this in mind, we feel that the Congress should pursue policies which enable Sallie Mae to assist state agencies (at their request) and to compete fairly in providing such services. For this reason, we believe the new authority granted to Sallie Mae is far to broad and should be curtailed.

3. **For states that have established student loan authorities allowing colleges to raise funds by issuing tax exempt bonds, backing such loans by pledging all or part of their assets, such as physical plant or endowments as collateral, and should such states (including West Virginia) find that it cannot pay back its obligation under the bonds when payment comes due--can state guaranty or lending agencies come to their assistance?**

What about Sallie Mae's authority to deal in such uninsured loans--what might be the adverse effects on both the colleges or state agencies should this come to pass?

I would recommend another alternative which would be less objectionable and less expensive to the Federal Government. Simply, change the Federal statutes so Federal reinsurance would be maintained on those GSL's not qualifying under the needs test. The Federal Government would pay no interest or special allowance; therefore, costs in the PLUS Program would be reduced or limited, and states could then subsidize the interest, if they desired.

By allowing these borrowers who cannot meet the needs test to pay the prevailing cost of borrowing, the government's costs would be limited to the possibility of default payment, which would be far less among this group of borrowers.

4. Do you agree that Sallie Mae's authority to go into a state, in agreement with the secretary, to provide student loan access if a determination is made that such state is either unwilling or unable to provide for student credit needs, is of concern because they are in a position to create that circumstance of "unwillingness or inability" on the part of a state agency because of state agency, current, or future, dependency on the association to provide cash-flow? In other words, if Sallie Mae either refuses, or delays negotiation of agreements between state agencies, it could create a lack of funds for student loans and thus create a situation where need is not being met--opening the way for Sallie Mae and the Secretary to "order Sallie Mae into the state" to fill that need.

Is the foregoing the reason for the grave concern on the part of state agencies with that particular new authority for Sallie Mae?

How can that authority be amended to se restrict Sallie Mae to alleviate state concerns?

Do you recommend outright repeal of that authority?

Would you accept a requirement that the authority include a consultation with state agencies or higher education entities before the secretary made a determination that unmet need existed in a state, before Sallie Mae is allowed in?

Given Sallie Mae's record on negotiating takeout commitments and other financial arrangements, as well as its demonstrated lack of concern for the interests of state agencies, such a situation could exist. In addition, the other financial institutions which provide services in competition with Sallie Mae (chiefly money center banks) may withdraw from future involvement with such services on very short notice. Therefore, a forced unmet need due to the inability of a state agency to work with Sallie Mae could in fact occur.

We strongly recommend that any determination require state approval before any alternative plan be implemented.

5. **In connection with Sallie Mae's sole authority to consolidate, do you believe sole authority should be removed from law, and state agencies given the option to consolidate?**

How would giving state agencies the option to consolidate help keep down default rates, and how would it save the government money?

We strongly support a removal of the sole authority provision for Sallie Mae and a change which would also give state agencies the option to consolidate.

Enabling Sallie Mae to consolidate different loans while not permitting state agencies to do so places state agencies at a competitive disadvantage in offering services to students. Under the consolidation provisions, Sallie Mae may extend the loan amortization schedule to up to 20 years as well as offer a graduated repayment schedule. Both of these provisions may be very advantageous to students, as well as the obvious simplification of paying only one monthly loan.

Permitting state agencies to consolidate loans from different programs would potentially reduce defaults by allowing the agency to adopt the repayment schedule to the student's ability to pay. It would also simplify the servicing and tracking required of the agency, which has in the past been helpful in reducing default rates.

Program costs would be reduced since state agencies only receive half of the SAP interest payments that Sallie Mae receives.

In addition, Sallie Mae can come into a state and purchase, out of a state's secondary market, all the larger balance loans, leaving the state program with small balance loans which are more costly to service.

We hope you and Senator Stafford will sponsor legislation allowing states the ability to consolidate loans and put an end to Sallie Mae's monopoly in this area.

6. **Sallie Mae recently sought the concurrence of the Secretary of Education in its view that Sec. 438(B)(2)(I) of the Act does not preclude the special allowance to states on GSLP loans made by those states with proceeds of advances from Sallie Mae. The Secretary, by his letter dated June 7, 1982 to Mr. Ed Fox, did not concur with their view.**

What is the state agency position on this question, and how would it affect state agencies if the Secretary, or the Congress, does concur with Sallie Mae's view?

The issue raised in Section 438(B)(2)(I) of the Act actually extends beyond advances by Sallie Mae. The section specifies that a holder of a loan who financed the purchase of the loan through tax-exempt sources of funds shall receive one-half of the special allowance payments. Sallie Mae sought the opinion of the Secretary as to the special allowance payments if a tax-exempt entity - such as a state agency - issues taxable obligations to refinance its loans originally financed by tax-exempt obligations. It seems logical to argue that in this case its source of funding is taxable and therefore deserves the full special allowance. The Secretary seems to be arguing that an organization must make a choice as to issuing taxable debt or tax-exempt debt, and once the choice is made to undertake a tax-exempt financing, this situation may never be reversed.

Further examination to determine if there is a real need for this should be undertaken as cost of the GSL Program would be increased dramatically which would have a negative effect.

7. **Sallie Mae probably will seek authority to lend directly to colleges enabling them to make uninsured loans, through local banks. What is your position on such proposals? If you agree, who should set the terms for such loans, and how high an interest rate should be required of students obtaining such loans?**

We believe that if states could provide Federally insured, non-interest subsidized loans to those students not meeting the current Federal need formula, that all demands would be met. This would continue to provide students with loan access from their state programs and would not proliferate the program by adding another layer of bureaucracy. In addition, students would receive funds from a non-prejudiced agency to attend the college of their choice.

We would oppose this new authority.

8. It is the Expressed opinion of Sallie Mae that the $5 Billion they have borrowed (as of January 1982) from the federal financing bank does not constitute and cannot be called " Federal Funding", "TaxPayer Dollars", or "Federal Contributions" for Sallie Mae's purposes.

Do you agree? If not why not. If you do Agree, Explain.

There is little doubt that the initial borrowings of Sallie Mae were subsidized by the Federal government, since Sallie Mae paid the Federal government 1.25% above the T-Bill auction rate, and are guaranteed a minimum 3.5% above the T-Bill rate as a return from the Federal government on student loans. In addition, they pay private investors considerably more than 1.25% above T-Bill rates. If Sallie Mae continues with this type of logic, it would appear they could immediately refinance the $5 billion debt and repay the Federal government since they maintain there is no advantage to the Federal financing.

9. Do you believe the temporary exemption from Federal Priority under bankruptcy statutes for Sallie Mae now in effect, but due to Expire September 30, should be made permanent?

If so, Why? If not, Why? If such exemption is extended, would it be better to limit it to no more than two additional years, and then conduct oversight hearings again on the issue?

We would strongly encourage you to limit this extension to only one or two years, as it is the only check and balance you have on Sallie Mae activities.

10. Sallie Mae Pays no State or Local Taxes.

Should Sallie Mae be requried to pay at least local taxes in the District of Columbia on its transactions/profits?

Should Sallie Mae be requried to pay state taxes on profits made in the states where it provides liquidity, etc?

Explain views.

Since Sallie Mae is a private profit-making corporation, we believe they should pay taxes in the district and state.

Senator STAFFORD. The committee stands adjourned.
[Whereupon, at 12:32 p.m., the subcommittee was adjourned.]